Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements	**WC Docket No. 02-112**

Declaration

of

LEE L. SELWYN

on behalf of

AT&T Corp.

August 5, 2002

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DECLARATION OF LEE L. SELWYN

Introduction

Lee L. Selwyn, of lawful age, declares and says as follows:

1. My name is Lee L. Selwyn; I am President of Economics and Technology, Inc. ("ETI"), Two Center Plaza, Suite 400, Boston, Massachusetts 02108. ETI is a research and consulting firm specializing in telecommunications and public utility regulation and public policy. My Statement of Qualifications is annexed hereto as Attachment 1 and is made a part hereof. I have been asked by AT&T to review the *Notice of Proposed Rulemaking* ("NPRM") issued by the Commission in the above-captioned proceeding, to analyze the issues and questions raised therein, and to provide the Commission with specific recommendations thereon.

2. I have participated in proceedings before the Federal Communications Commission ("FCC" or "Commission") dating back to 1967 and have appeared as an expert witness in hundreds of state proceedings before more than forty state public utility commissions. I have participated in numerous regulatory proceedings involving public utility affiliate relationships and inter-affiliate transactions and transfers. These have included merger proceedings before the California PUC involving Pacific Telesis Group and SBC, and Bell Atlantic and GTE, before the Illinois Commerce Commission involving SBC and Ameritech, before the Connecticut Department of Public Utility Control involving SBC and SNET, and before the Maine PUC involving NYNEX and Bell Atlantic. I also participated in written comments filed with the FCC regarding both the SBC/Ameritech and Bell Atlantic/GTE merger applications. I have participated in a number of Section 271 proceedings, including those in Pennsylvania, New Jersey, California, Minnesota, Delaware and Virginia. I have also submitted testimony before several state commissions addressing proposals for structural separation of ILEC wholesale and retail operations. I participated in proceedings before the California PUC involving Pacific Bell's reorganization of its Information Services (primarily voice mail) business into a separate subsidiary, and the spin-off of Pacific Telesis Group's wireless services business into a separate company. I have participated in a number of matters involving the treatment of transfers of yellow pages publishing from the ILEC to a separate directory publishing affiliate, including the recent case before the Washington Utilities and Transportation Commission addressing imputation of (then) US WEST yellow pages revenues.

Summary

3. Congress established the requirement for structural separation of the BOC ILEC and long distance entities and the associated transactional and nondiscrimination requirements because it understood that mere satisfaction of the Section 272(c)(2)(B) "competitive checklist" was not by itself sufficient to constrain or otherwise diminish a BOC's market power with respect to local and access services. Absent appropriate safeguards and the means to enforce them, BOCs have both the capability, as an economic matter, and the strong financial and business incentive, to leverage their local service market power over to the adjacent, and presently highly competitive interLATA long distance market. It is thus critically important that the separate affiliate requirement and its associated safeguards be retained in place until competition for local and access services has developed to the point where that capability is no longer present.

4. In fact, local and access services competition has not increased significantly in markets where Section 271 approval has been granted, due to the persistence of material economic barriers to entry and discriminatory conduct by the BOCs. Sections 272(b), (c) and (e) all *require* that (with the limited exception of certain activities related to joint marketing of local and long distance services) BOCs afford the same or superior treatment to competing firms with respect to pricing, service availability, service quality, and other terms and conditions, that the BOCs provide to their own long distance business. However, even with the relative transparency provided by Section 272, BOCs have persisted in "pushing the envelope" with respect to their inter-affiliate transactions, resulting in uncompensated transfers

of employees, assets and services the effect of which is to force customers of the monopoly ILEC entity to cross-subsidize the BOC's long distance service. Only those antidiscrimination safeguards provided for at Sections 272(e) would survive the separate affiliate sunset. Thus, in addition to creating a number of additional opportunities for discriminatory treatment of rivals, allowing the separate affiliate requirement to sunset would, as a practical matter, make detection of even the remaining antidiscrimination safeguards extremely difficult and in many cases virtually impossible. Extending the sunset will enable the Commission and the public to monitor such misconduct and thereby facilitate remedial measures that would work to curtail it. It is essential that the Section 272 separate affiliate and the associated transactional and nondiscriminatory requirements be retained. Moreover, in view of documented efforts by BOCs to flaunt these statutory obligations and Commission rules, the Commission should adopt additional measures that will help to assure full compliance with applicable law and regulation. If Section 272 is allowed to sunset at this time, there is a substantial risk that competition in both the local and long distance sectors will be rapidly eroded, and that the BOCs will come to dominate and thereby to remonopolize the (currently highly competitive) long distance market as well.

Background

5. Structural separation of the BOC and long distance entities is required by Section 272(a) for the first three (3) years following a BOC's receipt of Section 271 authority in a particular state,[1] and may thereafter be extended indefinitely by the FCC. Interactions between the structurally separated BOC and long distance entities with respect to the use or provision of common or shared resources must conform to a set of five conduct provisions set out at Section 272(b) and nondiscrimination requirements set out at Sections 272(c) and 272(e). The Section 272(b) code of conduct requires that the BOC's long distance affiliate:

> (1) shall operate independently from the Bell operating company;
>
> (2) shall maintain books, records, and accounts in the manner prescribed by the Commission which shall be separate from the books, records, and accounts maintained by the Bell operating company of which it is an affiliate;
>
> (3) shall have separate officers, directors, and employees from the Bell operating company of which it is an affiliate;
>
> (4) may not obtain credit under any arrangement that would permit a creditor, upon default, to have recourse to the assets of the Bell operating company; and
>
> (5) shall conduct all transactions with the Bell operating company of which it is an affiliate on an arm's length basis with any such transactions reduced to writing and available for public inspection.

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1. 47 U.S.C. § 272(b). The FCC has specifically characterized these requirements as "structural separation" in *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, CC Docket No. 96-149, First Report and Order and Further Notice of Proposed Rulemaking, 11 FCC Rcd 21905 (1996) (*Non-Accounting Safeguards Order*), at 11 FCC Rcd 21914.

The Section 272(c) nondiscrimination provisions require that in its dealings with its long distance affiliate, a BOC:

> (1) may not discriminate between that company or affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards; and
>
> (2) shall account for all transactions with an affiliate described in subsection (a) in accordance with accounting principles designated or approved by the Commission.

Section 272(e) requires that a BOC and its long distance affiliate:

> (1) shall fulfill any requests from an unaffiliated entity for telephone exchange service and exchange access within a period no longer than the period in which it provides such telephone exchange service and exchange access to itself or to its affiliates;
>
> (2) shall not provide any facilities, services, or information concerning its provision of exchange access to the affiliate described in subsection (a) unless such facilities, services, or information are made available to other providers of interLATA services in that market on the same terms and conditions;
>
> (3) shall charge the affiliate described in subsection (a), or impute to itself (if using the access for its provision of its own services), an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service; and
>
> (4) may provide any interLATA or intraLATA facilities or services to its interLATA affiliate if such services or facilities are made available to all carriers at the same rates and on the same terms and conditions, and so long as the costs are appropriately allocated.

Based upon the various Verizon and SBC Section 272(b)(5) affiliate transaction postings and service offers provided on the companies' websites[2] and the first Verizon Section 272 Audit report for New York,[3] it has become apparent that the various interactions between the BOCs and their respective 272 long distance affiliates raise serious questions as to the actual, *de facto* extent of "separation" that prevails in practice as between the two supposedly separate corporate units. A significant portion, although by no means all, of these interactions relate in some manner to activities associated with the "joint marketing," joint account administration, and combined billing of the BOCs' local and long distance services. Each of these activities is being undertaken by the BOC and its affiliate as if, for all practical purposes, Section 272 did not exist.

6. The purpose of the Section 272(a) separate affiliate requirement, the Section 272(b) code of conduct, and the Section 272(c) and 272(e) nondiscrimination requirements was *and is* to forestall the potential for discriminatory and anticompetitive conduct arising out of the ability, as an *economic* matter, of the BOC to extend its market power in the *local* telecommunications market into the adjacent long distance market.[4] The Commission has

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2. http://www.verizonld.com/regnotices/index.cfm?OrgID=1; http://www.sbc.com/public_affairs/regulatory_documents/affiliate_agreements/0,5931,199,00.html

3. *In the Matter of Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996*, CC Docket No. 96-150, Reports of Independent Accountants on Applying Agreed-Upon Procedures, prepared by PricewaterhouseCoopers LLP, filed June 11, 2001 and June 18, 2001. ("*New York 272 Audit Report*")

4. *Conference Report on S. 652, Telecommunications Act of 1996* (House of Representatives- February 01,1996), *Congressional Record*, H1171.

previously noted that Section 272 contains all of the necessary elements to constrain BOC exercise of this market power;[5] however, empirical evidence from states with Section 271 approval indicates that, as currently applied, Section 272 is not by itself sufficient prevent discrimination and anticompetitive behavior by the BOC for the benefit of its long distance affiliate.

7. Accordingly, for so long as the BOC ILEC entity continues to possess market power, the Commission should extend the requirement that BOCs operate their interLATA business activities through structurally separate affiliates as required by Section 272. Additionally, however, the Commission must ensure that BOCs do not continue to undertake merely superficial measures to comply with the separations requirements. Unless Section 272 is complied with in the manner intended by Congress and this Commission, consumers and competitors will have no protection against anticompetitive conduct on the part of the incumbent BOCs.

5. *In the Matter of Regulatory Treatment of LEC Provision of Interexchange Services Originating in the LEC's Local Exchange Area and Policy and Rules Concerning the Interstate, Interexchange Marketplace*, CC Docket No. 96-149, 96-61, *Opinion*, Rel. April 18, 1997 ("*LEC Interexchange Non-Dominant Order*"), 12 FCC Rcd 15756, at 15763.

Attainment by a BOC of Section 271 in-region interLATA authority cannot be construed as demonstrating or implying that the BOC no longer has market power or that the local service market in the state in which such authority has been granted has become competitive.

8. The instant consideration of either extending the separate affiliate and nondiscrimination requirements of Sections 272(a), (b) and (c) and/or of putting in place "any alternative safeguards ... in states where the statutory requirements have sunset"[6] must be made in the context of the history and background that gave rise to the separate affiliate requirement in the 1996 federal legislation. That history begins with the U.S. Department of Justice's ("DoJ") 1974 antitrust case against the pre-divestiture Bell System[7] in which the DoJ alleged, *inter alia*, that the Bell companies were using their local service monopoly to prevent competition in the adjacent long distance market. The *Modification of Final Judgment* ("MFJ"), the 1982 Consent Decree under which the former Bell System was broken up and the Bell Operating Companies ("BOCs") were divested from AT&T,[8] prohibited the divested BOCs from offering interLATA long distance services. This *structural remedy* was adopted specifically to prevent the BOC local service monopolies from using their monopoly market power in the local services market to block competition in the adjacent long distance market.

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6. *In the Matter of Section 272(f)(1) Sunset of the BOC Separate Affiliate and Related Requirements*, WC Docket No. 02-112, *Notice of Proposed Rulemaking*, Rel. May 24, 2002 ("*NPRM*"), at para. 1.

7. *United States v. Western Electric Company, Inc., et al*, Civil Action No. 74-1698 (D.D.C.).

8. *U.S. v. Western Electric Co. et al.*, 552 F. Supp. 131 (D. D.C., 1982), *aff'd sub nom. Maryland vs. U.S.*, 460 U.S. 1007 (1983); and *Modification of Final Judgment*, sec. VIII.B.

And because the BOCs were themselves precluded from providing long distance services, they were made to be *indifferent* as to which long distance carrier their customers might individually select. Section 271 of the federal *Telecommunications Act of 1996* ("Act" or “1996 Act”) replaced the MFJ long distance “line of business” restriction with a process by which BOCs could enter the “in-region” long distance market, provided that they implemented a series of specific measures that, in principle, would have the effect of irreversibly opening their previously monopolized local telecommunications markets to competitive entry.[9] To the extent that the *local* market itself becomes competitive, the BOCs’ ability to exert market power in the adjacent long distance market could be attenuated. Conversely, when a BOC such as Verizon or SBC is allowed to offer in-region long distance service in a less-than-fully-competitive local market, then the BOC acquires both the ability and the incentive to engage in precisely the same type of anticompetitive conduct that the *MFJ* was intended to prevent. In principle, this was also the purpose of Section 271.

9. Section 271(c) of the 1996 *Act* sets forth the specific requirements that a BOC must satisfy in order to obtain authority to provide in-region interLATA services. The BOC must, if applying under “Track A,” demonstrate that it has entered into at least one (1) inter-connection agreement with a competing local service provider providing service (other than by resale of the ILEC’s services) to residential customers and to business customers, although

9. *See*, e.g., *In the Matter of the Application by Bell Atlantic New York for Authorization Under Section 271 of the Communications Act To Provide In-Region, InterLATA Service in the State of New York*, CC Docket No. 99-295, *Memorandum Opinion and Order*, 15 FCC Rcd 3953, 4164 (“*Bell Atlantic New York Order*”).

the existence of one agreement with a single carrier providing service to both groups would be sufficient (Section 272(c)(1)(A)). The BOC must also satisfy a "checklist" of fourteen "specific interconnection requirements" that, for the most part, are reiterations of obligations that are imposed by Section 251 upon *all ILECs* separate and apart from any long distance entry *quid pro quo*.

10. As interpreted by the FCC, Section 271 does not require a BOC to demonstrate that actual entry has occurred, that competing services are available generally throughout the state in question, or that the incumbent BOC has suffered or sustained any diminution of its preexisting market power.[10] In fact, the FCC has on several occasions *rejected* arguments, advanced by competing IXCs and others, that a BOC's continued dominance and pervasive control of the local market would make approval of its in-region interLATA entry contrary to the public interest notwithstanding its apparent satisfaction of the "competitive checklist."[11]

11. Inasmuch as the threshold conditions for the FCC's grant of in-region interLATA authority do not require the BOC to demonstrate, or the FCC to find, that *effective competi-*

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10. If the BOC is applying for Section 271 authority under "Track A" (i.e., Section 271(c)(1)(A)), it is only required to demonstrate that there is a minimum of just "one competing carrier" offering service to residential and to business customers in the state utilizing either the CLEC's own facilities or UNEs leased from the BOC. *In the Matter of Application of Ameritech Michigan Pursuant to Section 271 of the Telecommunications Act of 1934, as amended, To Provide In-Region, InterLATA services In Michigan*, CC Docket No. 97-137, *Memorandum Opinion and Order*, Rel. August 19, 1997, 12 FCC Rcd 20543, 20598.

11. *See*, e.g., *Bell Atlantic New York Order*, 15 FCC Rcd 4163.

tion has developed or that the BOC no longer has market power in the local service market in a given state, the fact that a BOC has obtained Section 271 in-region interLATA authority cannot be construed as implying that it no longer has market power or that the local service market in the state in which such authority has been granted — and particularly in all parts of that state — has become competitive. Indeed, in establishing the Section 272(a) and (b) separate affiliate requirements and the Section 272(c) and 272(e) nondiscrimination requirements, Congress clearly sought to dissociate a BOC's satisfaction of Section 271(c) with any finding or determination that it no longer had market power. On the other hand, Congress also understood that *if* the development of actual and effective competition in the local market were to occur, then the BOC's market power could be diminished or perhaps even eliminated. But Congress had no illusions about that taking place immediately upon enactment of the 1996 law, immediately upon a BOC's receipt of Section 271 authority in a given state or, for that matter, even after a finite and predetermined interval of time following such grant. Specifically:

- Congress established an explicit "separate affiliate" requirement (Section 272(a)) that would be *mandatory* for *at least* three years following a BOC's long distance entry in a given state;

- Tolling of that three-year clock commences not as of the date of enactment of the 1996 law, but as of the date upon which the BOC's Section 271 authority becomes effective, separately for each state for which such approval is obtained; and

- The FCC is empowered to extend the separate affiliate requirement beyond the initial three-year "sunset" period "by rule or order" and, based upon the Commission's determination in the instant *Notice*, may modify or adopt new rules pertaining to such affiliate relationship as part of or in lieu of such an extension.[12]

Elimination of the separate affiliate requirement at a time when the BOC still maintains extensive market dominance and market power would be inconsistent with, and would therefore frustrate, the specific policy goals underlying Section 272.

12. That the tolling of the three-year "sunset" period for Section 272(a) commences only as of the date that the BOC obtains Section 271 authority, rather than as of the date of enactment of the 1996 law (February 8, 1996) or the date at which the FCC promulgated rules addressing the specific obligations applicable to ILECs for dealing with CLECs (August 8, 1996), further demonstrates Congress' understanding that the mere establishment of formal legal requirements does not by itself assure that they will be effective in achieving the legislation's goals. To the extent that *noncompliance* by the BOCs would work to extend their legacy monopoly and forestall revenue erosion, BOCs continue to have strong financial and business incentives to move as slowly as possible to open their networks to competition.[13]

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12. *NPRM*, at para. 1.

13. SBC's Vice President for marketing, J. David Gallemore, was quoted in a 1995 *Business Week* interview as stating that "[w]e are at a critical juncture," and "*we want to make our welcome mat [for competitors] smaller than anyone else's*." "Pick of the Litter: Why SBC is the Baby Bell to Beat," *Business Week*, March 6, 1995 (emphasis supplied).

Congress understood and recognized that it could not *legislate* a competitive market into existence; what it could do is to enact laws that would, if fully complied with, make competition *possible* both as an economic and as a legal matter, and to adopt measures designed to *encourage* the BOCs to take steps that are in other respects at odds with their business and financial interests. Each and all of the "fourteen points" contained in the Section 271(c)(2)(B) "competitive checklist" appear elsewhere in the statute as obligations imposed upon *all* incumbent local exchange carriers *separate and apart from the matter of long distance entry* (see Table 1 below). Viewed in that context, Section 271(c)(2)(B) is thus *entirely redundant* at least insofar as specifying the things that BOCs (as ILECs) are required to do to accommodate CLEC entry; its sole purpose was to offer the BOCs a "reward" that perhaps would overcome their otherwise natural incentive to resist compliance to the greatest possible extent. However, once the "checklist" has been "satisfied" and in-region entry has been achieved, the compliance "carrot" will no longer be there, and those same business and financial incentives will once again dominate BOC conduct.[14] In expressly authorizing the FCC to extend the sunset date for the Section 272 separate affiliate requirement, Congress well understood that there is simply no basis to assume or to expect that merely as a result of

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14. The FCC is cognizant of this "backsliding" potential, and has adopted measures designed to overcome it. *Bell Atlantic New York Order*, 15 FCC Rcd 4174-4177. At bottom, however, the entry "carrot" and the backsliding "stick" are in no sense symmetric because, as a practical matter, it will be far more difficult to *rescind* a BOC's in-region long distance authority in the event of post-approval noncompliance than it had been to grant it as a reward for (pre-approval) compliance.

Table 1

BOC Compliance with all of the Sec. 271(c)(2)(B) "checklist" items is Mandatory Even if the BOC Does Not Seek In-Region InterLATA Authority

Checklist	Compliance requirement	Also Found At
1	Interconnection in accordance with the requirements of sections 251(c)(2) and 252(d)(1).	251(c)(2); 252(d)(1)
2	Nondiscriminatory access to network elements in accordance with the requirements of sections 251(c)(3) and 252(d)(1).	251(c)(3); 252(d)(1)
3	Nondiscriminatory access to the poles, ducts, conduits, and rights-of-way owned or controlled by the Bell operating company at just and reasonable rates in accordance with the requirements of section 224.	251(b); 224
4	Local loop transmission from the central office to the customer's premises, unbundled from local switching or other services.	251(c)(3)
5	Local transport from the trunk side of a wireline local exchange carrier switch unbundled from switching or other services.	251(c)(3)
6	Local switching unbundled from transport, local loop transmission, or other services.	251(c)(3)
7	Nondiscriminatory access to ((i) 911 and E911 services; (ii) directory assistance services to allow the other carrier's customers to obtain telephone numbers; and (iii) operator call completion services.	251(b)(3); 251(c)(3)
8	White pages directory listings for customers of the other carrier's telephone exchange service.	251(b)(3)
9	Compliance with guidelines, plan or rules established by numbering plan administrator.	251(e)
10	Nondiscriminatory access to databases and associated signaling necessary for call routing and completion.	251(a); 251(c)(3); 251(c)(5)
11	Compliance with FCC regulations regarding number portability.	251(b)(2)
12	Nondiscriminatory access to such services or information as are necessary to allow the requesting carrier to implement local dialing parity in accordance with the requirements of section 251(b)(3).	251(b)(3)
13	Reciprocal compensation arrangements in accordance with the requirements of section 252(d)(2).	252(d)(2)
14	Telecommunications services are available for resale in accordance with the requirements of sections 251(c)(4) and 252(d)(3).	251(c)(4) and 252(d)(3)

the passage of time (i.e., three years), the BOCs' market power would have diminished to the point where that separate affiliate and associated nondiscrimination requirements are no longer necessary.

13. What Congress has done is to create a transition between the outright prohibition of long distance entry that had prevailed under the MFJ, to unfettered BOC participation in in-region long distance, using a transitional separate affiliate mechanism that could be extended by the FCC beyond the minimum three-year period.[15] This transitional mechanism provides important safeguards against BOC anticompetitive conduct that had been unnecessary under the pre-1996 MFJ "line-of-business" outright prohibition against long distance entry. The Section 272(a) and (b) separate affiliate requirements and 272(c) and (e) nondiscrimination requirements serve two separate objectives:

(1) By requiring that the long distance affiliate "operate independently" vis-a-vis the BOC ILEC entity and by expressly prohibiting "discriminat[ion] between that company or affiliate and any other entity in the provision or procurement of goods, services, facilities, and information, or in the establishment of standards," the BOC is limited as to the extent to which it can confer any unique competitive advantage, arising from its incumbency and certain potential economies of network integration, upon its affiliate long distance entity, to the detriment of nonaffiliated IXCs; and

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15. 47 U.S.C. § 272(f)(1).

(2) By requiring that the details of inter-affiliate transactions and transfers of assets and services be made at fair market value, posted on the BOC's website, and ultimately subject to periodic audit, BOC conduct that is inconsistent with the statute is made more easily detectible than it would be if the BOC were permitted to conduct its largely monopolistic local and competitive long distance businesses on a fully integrated basis.

The Congressional purpose for the separate affiliate requirement is not served if all that the requirement entails are nominal bureaucratic constructs easily "satisfied" by the BOC and its 272 affiliate by merely maintaining facial separation.[16] Yet on the basis of the affiliate agreements entered into by Verizon and SBC and their 272 Affiliates, the pricing plans offered by Verizon Long Distance and SBCS, as well as the reported results of the first Verizon New York 272 audit, it is now evident that these two BOCs seek to interpret and to apply the separate affiliate requirement in precisely that superficial a manner and, wherever

16. In Section 271 proceedings before state commissions, BOCs have made a special effort to deflect attention away from any of the Section 272 requirements. For example, Dr. William E. Taylor, testifying for Qwest in Minnesota, has actually claimed that "the Act does not impose complete structural separation between a BOC and its 272 affiliate. Indeed, its central requirement that transactions between the two be posted and made available to other carriers is based on the assumption that the two will share services, that such sharing reflects economies and efficiencies that should be permitted, and that the way to prevent any anticompetitive behavior is to make those terms and conditions available to the competitors of the 272 affiliate." Minnesota PUC Docket No. P-421/C1-01-1372, OAH Docket No. 7-2500-14487-2, Affidavit of Dr. William E. Taylor, December 28, 2001, at para 7. At the very least, it would appear that Dr. Taylor shares my view as to the importance of retaining the separate affiliate and associated conduct and nondiscrimination requirements beyond the three-year sunset date.

possible, to conduct their business transactions and relationships *as if the separate affiliate requirement did not exist*. Elimination of the separate affiliate requirement and with it the lens of public scrutiny of BOC inter-affiliate transactions will make conduct such as misallocation of costs and the resulting creation of cross-subsidies virtually undetectable, affording the BOCs opportunity and incentive to expand the scope of such anticompetitive behavior going forward.

BOCs retain market power in the local market and retain the ability to cross-subsidize their long distance services and to otherwise discriminate against nonaffiliated IXCs.

14. The FCC has defined market power as, *inter alia*, "the ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable."[17] In a competitive, multi-firm market, consumers are able to shift their purchases easily among the various suppliers in response to any unilateral action by any individual firm to raise its price above the competitive market level. Under these conditions, consumers can be expected to respond to a price increase initiated by any one firm by rapidly shifting their business to another provider whose prices have remained stable. As a result, the attempt by the first firm "to raise and maintain price above the competitive level" will not be successful, and could not be sustained. While BOCs have repeatedly claimed that they

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17. *Competitive Carrier Fourth Report and Order*, 95 FCC 2d at 558, at para. 8 (citing *inter alia* W.M. Landes & R.A. Posner, *Market Power in Antitrust Cases*, 94 Harv. L. Rev. 937, 937 (1981), and A. Kahn, *The Economics of Regulation* 65-66 (1970)). The 1992 Department of Justice/Federal Trade Commission Merger Guidelines similarly define market power as "the ability profitability to maintain prices above competitive levels for a significant period of time." 1992 Merger Guidelines, at 20,570.

confront competition in the local telephone service market — and have sought to support those contentions with "head counts" of purported "competitors" — at bottom there has never been any demonstration that BOCs are *not* able "to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable." To the contrary, while feigning competitive pressures, BOCs have frequently *raised their prices* when given the "pricing flexibility" to do so, and have almost never responded to CLEC pricing initiatives by dropping their rates in areas in which CLECs have achieved some actual presence. Hence, there is no basis for the Commission to find that there has been *any* consequential diminution of BOC market power in the local services market since the date of enactment of the 1996 law.

15. The requirements that a market is *open* to competition, the standard applied by the FCC when considering BOC section 271 applications, teaches nothing about the BOC's retention of market power in that local market. Without viable, readily available customer choice among local service providers, no theoretical ability of a competitor to enter the market will meaningfully restrict a BOC's incentive or ability to raise local prices above competitive levels. Indeed, this Commission specifically anticipated that a BOC would retain and be able to exercise local market power even after grant of authority to provide in-region interLATA services:

> Although we are classifying these carriers as non-dominant with respect to their provision of in-region and out-of-region long distance services, as summarized above, we recognize that, *as long as these carriers retain market power in providing local exchange and exchange access services, they will have some*

> *incentive and ability to misallocate costs to local exchange and exchange access services, to discriminate against their long distance competitors, and to engage in other anticompetitive conduct*.[18]

To the best of my knowledge, the Commission has *never* determined, with respect to any of its Section 271 rulings, that the BOC under inquiry no longer had market power or would be incapable of "misallocat[ing] costs to local exchange and exchange access services, [of] discriminat[ing] against their long distance competitors, and [of] engag[ing] in other anticompetitive conduct."

16. The Commission's chosen solution to the potential for anticompetitive conduct stemming from BOC market power was, *inter alia*, the application of Section 272:

> In light of the requirements established by, and pursuant to, sections 271 and 272, together with other existing Commission rules, we conclude that the BOCs will not be able to use, or leverage, their market power in the local exchange or exchange access markets to such an extent that their section 272 interLATA affiliates could profitably raise and sustain prices of in-region, interstate, domestic, interLATA services significantly above competitive levels by restricting the affiliate's own output.[19]

This linkage between "sections 271 and 272, together with other existing Commission rules" and the BOCs' ability "to use, or leverage, their market power in the local exchange or exchange access markets to such an extent that their section 272 interLATA affiliates could profitably raise and sustain prices of in-region, interstate, domestic, interLATA services

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18. *LEC Interexchange Non-Dominant Order*, 15764-15765, emphasis supplied.

19. *Id.* at 15763.

significantly above competitive levels by restricting the affiliate's own output" is no less valid today and for the foreseeable future than it was in 1997 when this determination was made. Put differently, were the Commission to permit the Section 272 separate affiliate requirement and its associated 272(b) code of conduct to expire, there is little doubt that the BOCs *would* "be able to use, or leverage, their market power in the local exchange or exchange access markets to such an extent that their section 272 interLATA affiliates could profitably raise and sustain prices of in-region, interstate, domestic, interLATA services significantly above competitive levels by restricting the affiliate's own output."

17. The BOCs' local market power has not diminished since 1997. When considering the bundling of services in March 2001, the Commission again found that BOCs retain market power in the local exchange market, and again based its policy upon the conclusion that Section 272 provided a check on the ability of a BOC to leverage its local market power into adjacent markets:

> Despite the inroads made by competitors into the local exchange market that we described above, incumbent LECs retain market power in the provision of local service within their respective territories. Thus, unlike our previous analysis of the interexchange market or nondominant LECs, incumbent LECs possess one of the essential characteristics for engaging in anticompetitive behavior — market power with respect to one of the components in the bundle. Nonetheless, we conclude, in light of the existing circumstances in these markets, that the risk of anticompetitive behavior by the incumbent LECs in bundling CPE and local exchange service is low and is outweighed by the consumer benefits of allowing such bundling. We view the risk as low not only because of the economic difficulty that even dominant carriers face in attempting to link forcibly the

> purchase of one component to another, *but also because of the safeguards that currently exist to protect against this behavior*.[20]

18. As recently as July 15 of this year, FCC Chairman Michael Powell was quoted in *The Wall Street Journal* reiterating the conclusion that BOCs have been slow to lose their market power in the local market: "We correctly believed these markets didn't need to be natural monopolies and they could be competitive, but I think we tended to over-exaggerate how quickly and how dramatically it could become competitive."[21]

19. The FCC is not alone in remaining concerned about BOC local market power and its potential anticompetitive effects. The New York PSC has recently found that Verizon New York remains dominant in the special services (i.e. UNEs and special access) market:

> Verizon's data, as well as the advantages attendant upon its historical incumbent position, indicate it continues to occupy the dominant position in the Special Services market, and by its dominance is a controlling factor in the market. Because competitors rely on Verizon's facilities, particularly its local loops, Verizon represents a bottleneck to the development of a healthy, competitive market for Special Services. In this situation, regulation is needed to assure the development of competitive choices, and good service quality when choices are not available. Accordingly, we find that a competitive facilities-based market for

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20. *In the Matter of Policy and Rules Concerning the Interstate, Interexchange Marketplace; Implementation of Section 254(g) of the Communications Act of 1934, as amended*; CC Docket No. 96-61; *1998 Biennial Regulatory Review — Review of Customer Premises Equipment And Enhanced Services Unbundling Rules In the Interexchange, Exchange Access And Local Exchange Markets*, CC Docket No. 98-183, *Report and Order*, Rel. March 30, 2001, 16 FCC Rcd 7418, 7438, emphasis supplied. At 16 FCC Rcd 7434, the Commission specifically notes Section 272, *inter alia*, as providing sufficient protection against the market power of the BOCs.

21. "FCC's Powell Says Telecom 'Crisis' May Allow a Bell to Buy WorldCom," *The Wall Street Journal*, July 15, 2002, at A1, A4.

> Special Services has yet to emerge and that Verizon continues to dominate the market overall.[22]

CLECs and IXCs depend heavily upon BOC special services in order to furnish retail local and long distance services to their own customers. By virtue of their control over these bottleneck facilities, BOCs are in a position to restrict the availability of these essential services to their rivals. If the special services market were competitive, the creation of artificial limitations on service availability would not be possible.

20. In a Draft Decision released July 23, 2002 in the current Pacific Bell Section 271 consultative proceeding in California, the presiding Administrative Law Judge, while on the one hand finding that Pacific Bell had satisfied 12 out of the 14 checklist items and on that basis recommending that the California Commission so advise the FCC, nevertheless observed that:

> Local telephone competition in California exists in the technical and quantitative data; but it has yet to find its way into the residences of the majority of California's ratepayers. Only time and regulatory vigilance will determine if it ever arrives. We expect that the public interest will be positively served in California by the addition of another experienced, formidable competitor in the intrastate interexchange market. At the same time, we foresee the harm to the public interest if actual competition in California maintains its current anemic

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22. *Proceeding on Motion of the Commission to Investigate Methods to Improve and Maintain High Quality Special Services Performance by Verizon New York Inc.*, Case 00-C-2051, *Proceeding on Motion of the Commission to Investigate Performance-Based Incentive Regulatory Plans for New York Telephone Company*, Case 92-C-0665, before the New York Public Service Commission, *Opinion and Order Modifying Special Services Guidelines for Verizon New York Inc., Conforming Tariff, and Requiring Additional Performance Reporting*, June 15, 2001, at 9.

> pace, and Pacific gains intrastate long distance dominance to match its local influence.[23]

Other state commissions have similarly found that ILECs retain substantial market power with respect to local and access services. The Indiana Utility Regulatory Commission recently concluded:

> However, we cannot ignore the potential negative consequences or anti-competitive effects that could flow from an unrestricted grant of authority to an affiliate of the largest ILEC in Indiana. The conditions that are ordinarily imposed on facilities-based carriers are only a starting point as those conditions were designed primarily for CLECs. This docket involves certification of an affiliate of the largest ILEC in the state. This Cause also involves an affiliate intending to use advanced technology and investment in the public network for the provision of advanced services. Ameritech Indiana as the dominant local exchange provider has the incentive and capability to exercise market power.[24]

The Montana PUC echoed Indiana's concern:

> The Commission is sympathetic to the concerns expressed by the parties and recognizes that the competitive local exchange market will likely create opportunities for customers to obtain services from alternate providers even though they may have delinquent accounts with a competitor. This will be a change for the incumbent LEC which has been the only provider of telecom-

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23. Calif. PUC, *Draft ALJ Decision Granting Pacific Bell Telephone Company's Renewed Motion for an Order that it has Substantially Satisfied the Requirements of the 14-point Checklist in § 271 of the Telecommunications Act of 1996 and Denying that it has Satisfied § 709.2 Of the Public Utilities Code*, R.93-04-003 *et seq*., released July 23, 2002 ("*California PUC Draft 271 Decision*").

24. *In the Matter of the Petition of Ameritech Advanced Data Services of Indiana, Inc. (Which Is In the Process of Adopting the Business Name of SBC Advanced Solutions, Inc.) For A Certificate of Territorial Authority to Provide Facilities-based and Resold Telecommunications Services Throughout the State of Indiana and Requesting the Commission to Decline to Exercise Jurisdiction Pursuant to I.C. 8-1-2.6*, Indiana Utility Regulatory Commission Cause No. 41660, *Opinion*, 2001 Ind. PUC LEXIS 275, approved May 19, 2001, at *39-*40.

> munications service in the past and which still has near total market power, particularly in rural states like Montana.[25]

21. Raw data purporting to quantify the extent of CLEC market penetration that has been offered by BOCs in various Section 271 proceedings is, at a minimum, highly controversial[26] and, consistent with the California ALJ's finding, does not establish that competition exists "on the ground" at a level that offers consumers a realistic alternative to the BOC's services or that works to limit or constrain the BOC's market power.

22. The FCC Industry Analysis and Technology Division's latest figures for local competition also belie any claims by BOCs that they have lost market power. As of December 2001, CLECs nationally had only a 10% local market share, and some 38% of US zip codes lacked even a single competitive local provider.[27] Despite BOC claims that their

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25. *In the Matter of the Application of Citizens Telecommunications Company of Montana and CommSouth Companies, Inc., Pursuant to Section 252(e) of the Telecommunications Act of 1996 for Approval of Their Resale Agreement*, Montana Public Service Commission, Utility Division Docket No. D2000.7.104; Order No. 6281, *Final Order*, Montana Public Service Commission, 2000 Mont. PUC LEXIS 121, October 16, 2000, at 13.

26. In seeking to quantify the extent of CLEC market presence, BOCs have relied upon CLEC E911 database entries adjusted to exclude UNE-Loops, as indicative of the number of CLEC facilities-based lines. But E911 database records are keyed to *telephone numbers*, not telephone *lines*, and in the case of multiline business customers the quantity of individual telephone numbers may be a multiple of the number of individual lines. In addition, BOCs have typically not excluded from the E911 "number counts" non-UNE BOC facilities that are being leased to CLECs such as and including Special Access lines. In fact, since CLECs are frequently unable to utilize UNE-loops to serve multiline business customers, the quantity of BOC Special Access facilities being leased by CLECs likely represents a substantial fraction — possibly even the *majority* — of CLEC-provided retail lines.

27. FCC Industry Analysis and Technology Division, *Local Telephone Competition: Status as of December 2001*, Rel. July 23, 2002, ("*Local Competition Report*"), at Tables 6 and 14.

entry into the interLATA market is the catalyst that will stimulate CLEC entry, the "facts on the ground" do not come even remotely close to supporting that contention. For one thing, even for those states in which CLEC retail penetration is highest, the penetration of *facilities-based* competitive services is minimal. According to FCC data, for the sixteen states in which in-region long distance entry has been permitted (which include fourteen BOC states that have attained Section 271 authority plus Connecticut and Hawaii, where no such authority was required), BOCs (and, in the case of Connecticut and Hawaii, non-BOC ILECs) provide the underlying facilities for roughly 97.4% of all residential lines (see Table 2).

23. New York, the most frequently cited example of "robust" local competition, is still struggling with BOC local market power. A report including an analysis of local competition presented recently by the staff of the New York Public Service Commission (NYPSC) indicates that CLEC penetration rates in New York actually *decreased* in the second quarter of 2001, suggesting that the initial CLEC gains following Verizon's interLATA entry could not be sustained.[28] The NYPSC staff attributes this drop to poor performance in the CLEC capital market, to UNE pricing problems, and to a myriad of small obstacles placed by Verizon on CLEC competitors attempting to interconnect or secure facilities from the BOC.[29] The NYPSC recently issued an order significantly reducing UNE rates,[30] and it is my understanding that CLEC activity has increased as a result. And that is the point: CLECs

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28. New York Public Service Commission, *In the Matter of Verizon– New York*, Case No. 00– C– 1945, Report of Commission Staff, February 2002, at 18-19.

29. *Id.*

30. *Proceeding on Motion of the Commission to Consider Cost Recovery by Verizon and to Investigate the Future Regulatory Framework*, NYPSC Case 00-C-1945, *Proceeding on Motion of the Commission to Examine New York Telephone Company's Rates for Unbundled Network Elements*, NYPSC Case 98-C-1357, *Order Instituting Verizon Incentive Plan*, New York Public Service Commission, February 27, 2002.

Table 2

CLEC Facilities-Based Residential Penetration
for States with BOC or ILEC In-Region InterLATA Authority

State	CLEC Residential Retail Market Share	Percent of CLEC Lines that are Facilities-based	CLEC Residential Facilities-based Market Share
Connecticut	3.87%	48.73%	1.88%
Hawaii	0.00%	0.00%	0.00%
New York	22.48%	20.33%	4.57%
Texas	11.27%	19.13%	2.16%
Kansas	7.02%	17.00%	1.19%
Oklahoma	4.28%	55.66%	2.38%
Massachusetts	10.59%	47.44%	5.02%
Pennsylvania	9.93%	43.15%	4.28%
Arkansas	0.00%	0.00%	0.00%
Missouri	3.84%	14.03%	0.54%
Rhode Island	13.48%	56.93%	7.68%
Vermont*	0.23%	0.00%	0.00%
Georgia	7.62%	27.91%	2.13%
Louisiana	0.52%	23.09%	0.12%
Maine	0.00%	0.00%	0.00%
New Jersey	1.55%	21.50%	0.33%
Weighted Average	9.87%		2.59%

Source: FCC, Wireline competition Bureau, Industry Analysis and Technology Division, *Local Competition Report*, Rel. July 23, 2002, at Tables 6, 8, and 9. Averages are weighted by total residential lines. States designated by IATD with CLEC penetration levels too small to maintain firm confidentiality are included as 0%. Facilities-based percentage is for total CLEC lines, however, since CLECs more commonly serve residential lines via UNE or resale arrangements, the CLEC facilities-based residential share figures likely overstate actual CLEC facilities-based residential shares. Data for Vermont is taken from Application by Verizon New England, Inc., et al, for Authorization To Provide In-Region, InterLata Services in Vermont, WC Docket No. 02-7, Verizon Brief, filed January 17, 2002, at 7 will attempt to enter and compete in the local market when they can do so profitably, not because the ILEC is or is not in the long distance business.

24. In fact, any CLEC competition that does exist is holding on by a thread. Last August (2001), CLEC analysts at Morgan Stanley Dean Witter noted that the market capitalization of CLECs as a group had fallen by 65.8% since January 1, 2001.[31] By July 22 of this year, the cumulative decrease in CLEC values since November 2001 had escalated to 40%.[32] As *The Economist* recently observed:

> The telecoms bust is some ten times bigger than the better known dotcom crash: the rise and fall of telecoms may indeed qualify as the largest bubble in history. Telecoms firms have run up total debts of around $1 trillion. And as if this were not enough, the industry has also disgraced itself by using fraudulent accounting tricks in an attempt to conceal the scale of the disaster.[33]

The Economist goes on to note that "[t]he likely winners, it is already clear, are the former "Baby Bells" in America and the former monopoly incumbents in Europe."[34] The cratering of CLEC share prices indicate that (1) investors have less confidence in these companies'

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31. Morgan Stanley Dean Witter, Equity Research: North America, Industry: Competitive Local Exchange Carriers (CLECs), August 14, 2001, at 1, provided in Attachment 10. In an earlier report issued by MSDW, its analysts indicated that "[u]nlike the last two CLEC market corrections, we do not believe that the current one is likely to end with the entire group rocketing back because, over the next six months, we expect news headlines to be peppered with reports of additional bankruptcies." Morgan Stanley Dean Witter, Equity Research: North America, Industry: Competitive Local Exchange Carriers (CLECs), November 7, 2000, at 2.

32. "Telecoms Adrift In Market Turmoil; TR Daily Telecom Index Plunges 4.6%", *Telecommunications Reports Daily*, July 22, 2002.

33. "The great telecoms crash," *The Economist*, July 20, 2000, at 9.

34. *Id.*

ability to succeed with business plans premised upon competing with ILECs, and (2) the companies themselves now will have much more difficulty attracting capital with which to pursue any future business plans. A facilities-based CLEC requires a substantial amount of up-front investment, and a lack of capital with which to pursue market entry will effectively block most such efforts. CLECs — particularly those still in business today — also require recurring infusions of capital to cover losses extant during the initial ramp-up phase of their operations, and the lack of such capital could well force what might otherwise have ultimately been a successful venture into Chapter 11 (as it did for NorthPoint, Covad, Rhythms, HarvardNet, Global Crossing and McLeod, to name a few). In fact, industry officials and financial analysts indicate that they do not expect the capital markets to open up anytime soon for most cash-starved CLECs, which is likely to force more CLECs to sell assets or go into bankruptcy. And those CLECs still in business, that BOCs claim as "competitors," hardly pose a serious or formidable competitive challenge at a level that would materially work to constrain a BOC's exercise of market power.

25. Even with the recent reduction in New York UNE rates, and even considering some of the recent CLEC successes there, Verizon New York retains significant local market power in much of the state. In fact, the area of New York State with the most CLEC activity, as measured by the percentage of total lines served by CLECs, is Rochester — an area *not even being served by Verizon New York*. In addition, the Poughkeepsie LATA, at year end 2000, showed only a 5% CLEC penetration rate.[35] While the statewide CLEC penetration rate in New York hovers in the low 20% range, New York State continues to have areas with little

35. New York Public Service Commission, *Analysis of Local Exchange Service Competition In New York*, Data as of December 31, 2000 (Available at: http://dps.state.ny.us/telecom/telanalysis.htm).

or no CLEC presence.[36] Where Verizon New York is the ILEC in these regions, the BOC not only retains market power, it in fact remains a monopoly. Until conditions across the state indicate that Verizon New York has lost its local market power, removing the Section 272 safeguards would disproportionately impact those consumers in areas with little or no competition.

26. Over the next year and a half, four states — New York, Texas, Kansas and Oklahoma — will reach the three-year sunset point. According to the FCC's most recent *Local Competition Report*,[37] CLECs in Kansas serve only 9% of the local market, while the CLEC share in Oklahoma is an even more dismal 8% (below the national average). This figure is likely to be even smaller now, since Global Crossing, a CLEC that was active in both Kansas and Oklahoma, has filed for bankruptcy since the December 2001 time frame of the data in the *Local Competition Report*.

27. Kansas and Oklahoma, the third and fourth states to receive Section 271 authority, have seen nowhere near the amount of competitive local growth that the BOCs attempt to ascribe to "271" states. More generally, a statistical examination of CLEC retail and facilities-based penetration rates as between states with and without ILEC in-region long distance authority finds no statistically significant link between in-region authority and CLEC penetration (see Attachment 2).

28. This uneven distribution of local competition in the states first receiving Section 271 authority belies any claim that the competitive local entry "spurred" by BOC long distance

36. *Local Competition Report*, at Table 14.

37. *Id.*, at Table 6.

entry has eliminated BOC *local* market power. There are several even more compelling examples that confirm this conclusion. At the time of the break-up of the former Bell System, two of the "Bell System" companies — The Southern New England Telephone Company ("SNET") in Connecticut and Cincinnati Bell, Inc. in Ohio and Kentucky — were only minority-owned by AT&T and were not required to be divested or made subject to the interLATA long distance line-of-business restriction that applied to all of the other Bell Operating Companies. AT&T voluntarily divested its remaining interest in both of these companies shortly after the break-up, and both were free to enter the long distance market at any time from 1984 onward. The GTE operating companies were not subject to the Bell MFJ line-of-business restriction, but became subject to a similar prohibition against long distance entry when GTE acquired a controlling interest in Sprint. However, the 1996 *Telecommunications Act* lifted the GTE long distance ban,[38] and the GTE companies were free to — and did — enter the long distance market as of the date of enactment, i.e., February 8, 1996. SNET, in fact, entered the Connecticut long distance market in 1993,[39] some *seven years sooner* than Verizon and SBC began offering such services in New York and Texas, respectively. Following enactment of the 1996 law and adoption of implementation rules by the FCC later than year, SNET and the GTE companies, all of which are ILECs as defined at 47 U.S.C. §251(h), were required to comply with the unbundling, resale, interconnection, and nondiscriminatory access to poles, ducts, conduit, operator services, directory assistance, directory listings as well as other the requirements of Sections 251 and 252 that I have previously enumerated (see Table 1 above). These obligations are very similar to the market opening requirements of Section 271(c)(2)(B), and when complied with by the ILECs *as they*

38. 47 U.S.C. § 601(a)(2).

39. SBC Investor Briefing, *SBC Enters $7.7 Billion Texas Long-Distance Market*, July 10, 2000.

are required to do would afford competitors the same ability to enter the local market in the *non-BOC* ILEC service areas as would prevail in BOC jurisdictions once the "competitive checklist" had been satisfied.

29. SNET is the dominant ILEC in Connecticut, and GTE (now Verizon) is the *sole* ILEC in Hawaii. If in fact there were any kind of *causal link* between ILEC long distance entry and the "stimulation" of local competition, one would expect to see rampant CLEC activity and market penetration in both of these states, as well as in such concentrated GTE (now Verizon) local service areas as southern California and the west coast of Florida. The facts speak otherwise. Studies by the FCC and others confirm that despite these ILECs' *early* long distance entry, very little competitive *local* entry has occurred. The CLEC share in Connecticut is only about 7%, and CLEC activity is virtually nonexistent in Hawaii.[40]

30. BOC retention of market power in the local market is also illustrated by the fact that, even in the place where CLECs are the most active — New York City — the incumbent BOC (Verizon) has failed to adjust its prices in response to competitor pricing initiatives. For example, Verizon New York provides basic residential service on a message-rate basis in most of New York City, with an untimed charge per local call of 10.6 cents. CLECs have introduced various new pricing regimes in an effort to differentiate their services from those of Verizon, including unlimited local calling and pricing plans that include thousands of local minutes.[41] However, even with CLEC penetration of the New York City residential market

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40. *Local Competition Report*, at Table 6. Connecticut had just 8% CLEC end-user switched access lines; Hawaii's CLEC share was so small that it was not even included in the FCC report, with the explanation, "data withheld to maintain confidentiality."

41. According to AT&T's website, AT&T offers a package of unlimited local minutes and
(continued...)

now exceeding 20%, Verizon New York has maintained "measured-only" pricing for basic service,[42] although the Company is apparently in the process of introducing a new "package" of residential basic service and vertical features, targeted to high-end customers in New York, that includes flat-rate local and intraLATA toll calling for $54.95 per month.[43] And in February of this year, Verizon received authority from the New York PSC to *increase* its basic residential rates throughout New York State.[44] Verizon's revealed conduct confirms that it has "the ability to raise and maintain price above the competitive level without driving away so many customers as to make the increase unprofitable."

31. Finally, the extraordinary difficulties that CLECs confront when attempting to compete with a BOC or other ILEC is compelling demonstrated by the fact that the two largest BOCs — Verizon and SBC — have themselves failed to actively pursue out-of-region local market entry (as CLECs) *even after having represented to the FCC that they would do so*. SBC, in its Joint Application for approval of its merger with Ameritech,[45] and Verizon,

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41. (...continued)
three vertical features in Manhattan for $23.90 per month. Talk America offers 5,000 local minutes, unlimited vertical features and long distance benefits to customers in Manhattan for $35.95 a month.

42. Verizon New York PSC Tariff No. 2, Second Revised page 22, eff. May 13, 2002.

43. Verizon NY PSC Tariff No. 1, Section 2, Original page 220, Original page 57, eff. July 26, 2002.

44. Verizon Press Release, "New York PSC Approves Verizon Regulatory Plan; Company Announces First Basic Rate Increase in 11 Years; Continues Commitment to Service Quality," February 27, 2002.

45. *In re: Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, for Consent to Transfer Control of Corporations Holding Board Licenses and*
(continued...)

in its Joint Application for approval of its merger with GTE,[46] each represented that following their respective mergers the two mega-ILECs would each commit to pursuing "out-of-region" entry in various local exchange service markets. SBC had identified thirty such markets (of which 17 were in what would become Verizon territory),[47] while BA/GTE (Verizon) committed to enter twenty-one markets.[48] Although various parties and their experts, including myself, were highly skeptical as to the legitimacy of these so-called "commitments," both sets of joint applicants insisted that their respective "national local strategies" would be aggressively pursued and would result in a significant enhancement of facilities-based local competition throughout the country.[49] In its Orders approving the two mergers, the FCC undertook to put some teeth into what were in other respects "soft" commitments on the part of the two sets of merger parties with respect to their out-of-region local entry plans. In its *SBC/Ameritech Order*, the Commission *required* SBC to undertake the promised out-of-region local entry, and indicated that the post-merger SBC would be fined

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45. (...continued) *Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95, and 101 of the Board's Rules*, Before the Federal Communications Commission, CC Docket No. 98-141, *Application* , Filed July 27, 1998 ("SBC/Ameritech Merger Application"), at Sec. II.A.1.

46. *Applications of GTE Corporation and Bell Atlantic Corporation, Description of the Transaction, Public Interest Showing and Related Demonstrations*, Before the Federal Communications Commission, CC Docket No. 98-184, *Application*, Declaration of Jeffrey C. Kissell, Filed October 2, 1998, ("*Bell Atlantic/GTE Merger Application*"), at para. 14.

47. *SBC/Ameritech Merger Application*, Attachment A: "New Markets for the New SBC"

48. *Bell Atlantic/GTE Merger Application*, at para. 14.

49. *Id.*, at para. 15; *SBC/Ameritech Application*, Affidavit of James S. Kahan, at para. 27.

as much as \$39.6-million for each of the 30 out-of-region markets that it did not enter.[50] In the *BA/GTE Order*, the FCC similarly imposed the threat of fines if BA/GTE failed to invest at least \$500-million in out-of-region CLEC activities, or provide service as a CLEC to at least 250,000 customer lines, by the end of 36 months following the merger closing date.[51] As it has turned out, of course, the skepticism of various commenters and the concerns of the FCC with respect to the veracity of these out-of-region local entry "commitments" were well-founded. Early last year, both SBC and Verizon announced that they had each abandoned or drastically scaled-back their out-of-region local entry plans.[52] The decision by both SBC

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50. *In re: Applications of Ameritech Corp., Transferor, and SBC Communications, Inc., Transferee, for Consent to Transfer Control of Corporations Holding Board Licenses and Lines Pursuant to Sections 214 and 310(d) of the Communications Act and Parts 5, 22, 24, 25, 63, 90, 95, and 101 of the Board's Rules*, CC Docket No. 98-141, *Memorandum Opinion and Order*, October 6, 1999, at Appendix C, para. 59(d). The FCC ordered:

> If an SBC/Ameritech Out-of-Territory Entity fails to satisfy any of the 36 separate requirements for each out-of-territory market on or before the deadlines set forth in Subparagraph c, SBC/Ameritech shall make a one-time contribution of \$1.1 million for each missed requirement (up to a total contribution of \$39.6 million per market and \$1.188 billion if SBC/Ameritech Out-of-Territory Entities fail to satisfy all 36 requirements in all 30 markets) to a fund to provide telecommunications services to underserved areas, groups, or persons.

51. *Applications of GTE Corporation and Bell Atlantic Corporation, Description of the Transaction, Public Interest Showing and Related Demonstrations*, CC Docket No. 98-184, *Memorandum Opinion and Order*, Rel. June 16, 2000, at paras. 43-48.

52. Rory J. O'Connor, "Looser Reins," *eWeek*, March 26, 2001; "SBC Says It Meets Merger Terms Despite Out-Of-Region Cutbacks," *TR Daily*, March 20, 2001. In an obvious effort to escape the heavy fines that would otherwise apply, on March 5, 2002, SBC represented to the FCC that it is in compliance with its out-of-region entry commitments "for 16 of the required 30 markets," averring that "SBC Telecom, Inc. ("SBCT"), the SBC business unit with this responsibility, ... is offering local exchange service to all business customers and all residential customers throughout the areas in the market that are either (a) within the local

(continued...)

and Verizon to refrain from active pursuit of an out-of-region CLEC entry strategy suggests either that (a) both companies have concluded that such ventures will not be profitable due to the substantial economic barriers and other hurdles that they would each have to overcome, or (b) the two companies have tacitly adopted a market allocation "agreement" in which each firm stays out of the other's territory. The first explanation clearly indicates the presence of substantial market power on the part of the incumbent LEC, while the second explanation would only be sustainable if entry by other CLECs is not a serious threat.

With market power in the *local* market, a BOC has the ability to extend its local monopoly into the long distance market, unless constrained by regulation.

32. As mentioned earlier, the MFJ prohibited the divested BOCs from offering interLATA long distance services. This *structural remedy* was adopted in order to prevent the BOC local service monopolies from using their monopoly market power in the local services market to block competition in the adjacent long distance market. The specific focus, at that time, was on the matter of *access* by competing long distance carriers to

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52. (...continued)
service area of the incumbent RBOC located within the PMSA of the market or (b) within the incumbent service area of a Tier I incumbent LEC (other than SBC/Ameritech) serving at least 10 percent of the access lines in the PMSA ..." Letter dated March 5, 2002 to William F. Caton, Acting Secretary, FCC, from Carlyn D. Moir, Vice President, Federal Regulation, SBC Communications, Inc. SBC's representations to the Commission notwithstanding, the SBC Communications, Inc. website expressly indicates that service is available only in the thirteen in-region (i.e., SWBT, Pacific Bell, Ameritech and SNET) states (see Attachment 3). Moreover, the SBC Communications, Inc. website, www.sbc.com, states that "SBC Communications, Inc. serves 20 of the largest U. S. markets," a figure that clearly does not include the out-of-region markets purportedly being served by SBC Telecom, the SBC out-of-region CLEC business unit. Significantly, the SBC website does not even mention or provide a link to SBC Telecom; the only means by which a consumer would know about SBC's out-of-region local service offerings is by tracking down "SBC Telecom" specifically. Clearly, this "out-of-region" CLEC activity is barely on SBC's radar screen.

terminate calls on the BOCs' *local* networks. Prior to the break-up, the Bell System local companies provided their long distance affiliate with a far superior quality of access to their local networks and customers than was being offered to the nonaffiliated "Other Common Carriers" ("OCCs").[53] For example, calls placed by BOC customers were in all cases automatically routed to their long distance affiliate whenever the customer dialed a call on a "1+" basis; OCC customers were forced to dial lengthy "access codes" and manually enter their billing account information. Additionally, the interconnection arrangements being provided by the BOCs to their long distance affiliate were far superior in a number of other qualitative respects; for example, BOC local and long distance billing was handled on an entirely integrated basis, and the BOC billing system was provided with "answer supervision" by the terminating carrier indicating when the called party answered the call as well as when the called party terminated the conversation by hanging up the phone. The BOC-affiliated long distance carrier was thus able to provide accurate long distance billing to its customers, whereas OCCs, whose interconnection arrangements with the BOCs typically did not include "answer supervision," would often bill for calls that were not answered or fail to bill for short calls that were.

33. The MFJ and subsequent implementing regulations focused heavily upon the so-called "equal access" requirement, a set of interconnection arrangements that was designed to end disparity in BOC/OCC traffic exchanges. Although the bulk of the "equal access" issues were resolved by the end of the 1980s, several sources of disparate treatment persisted until

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53. The term "Other Common Carriers" ("OCCs") was used to refer to interexchange carriers other than AT&T.

as late as 1999.[54] In establishing specific rules for implementation of the Section 272(b)(1) "operate independently" requirement, the Commission has focused particularly upon the "equal access" concerns, directing that all operating equipment and facilities be separately owned, and that installation and maintenance services be provided separately to the BOC and its affiliate. The FCC has applied section 272(b)(1) specifically to forestall BOC affiliate advantages such as those formerly enjoyed by the integrated AT&T in terms of access:

> We conclude that a BOC may not discriminate in favor of its section 272 affiliate by: 1) providing exchange access services to competing interLATA service providers at a higher rate than the rate offered to its section 272 affiliate; 2) providing a lower quality service to competing interLATA service providers than the service it provides to its section 272 affiliate at a given price; 3) giving preference to its affiliate's equipment in the procurement process; or 4) failing to provide advance information about network changes to its competitors.[55]

As I shall discuss in more detail below (at para. 58), it now appears that at least one BOC — BellSouth — has recently attempted to flaunt this nondiscrimination requirement as well, offering more favorable rates for switched access to its long distance affiliate than are available to other IXCs.

34. Prior to "equal access," BOCs had the ability to — and did — preemptively direct their *local service customers' business* to their long distance affiliate *each time the local customer dialed an interLATA or intraLATA toll call* and by so doing prevented competing carriers from providing service to — "addressing" — the BOCs' customers. This enormous

54. Although the BOCs were required by the MFJ and the FCC to route *interLATA* calls to the interexchange carrier selected by the customer as the "Presubscribed Interexchange Carrier") ("PIC"), BOCs were permitted to route 1+ *intraLATA* calls to their own networks until as recently as 1999 — three years following enactment of the 1996 federal legislation. 47 U.S.C. § 271(e)(2)(B).

55. *Non-Accounting Safeguards Order*, at 21914.

competitive advantage was partially resolved via a two-pronged policy framework that coupled a *structural* remedy with active regulatory initiative and involvement. Specifically, by structurally separating (in fact, divesting) the BOCs from their long distance affiliate, the BOCs' *incentive to discriminate* was effectively eliminated, since such discrimination would no longer afford the BOCs with any financial or market advantage. Then, by imposing an affirmative "equal access" requirement, the BOCs were forced to interconnect with all long distance carriers — including their former affiliate — on the same or equivalent qualitative and financial terms.

35. It is noteworthy that both the structural and regulatory initiatives launched by the MFJ were confined strictly to the *interLATA* market; BOCs were not required to separate their local and *intra*LATA toll services, nor were they required to provide the same level of "equal access" to competing nonaffiliated *intra*LATA toll carriers.[56] As a consequence, the BOCs did not confront the same "indifference" with respect to their end-user customers' choice of *intraLATA* carrier as they did with respect to interLATA services, and continued to preemptively route customer's intraLATA calls to the BOCs own intraLATA service. Without a corresponding intraLATA "equal access" requirement, the BOCs not surprisingly continued to overwhelmingly dominate the intraLATA long distance market, and were able to maintain that largely unchallenged position until the "equal access" requirement was

56. The industry model envisioned at that time by framers of the MFJ allocated interLATA services to IXCs, while placing local and intraLATA toll and access services with the divested BOCs. Since IXCs were not expected to compete for intraLATA toll services, the lack of an "equal access" requirement with respect to this segment did not receive very much attention. The 1996 *Act* replaced the MFJ model with one in which competition would be permitted *and accommodated* at all levels, which required that the "equal access" and associated nondiscrimination concepts become applicable for all local and intraLATA services as well as for the interLATA segment that had been addressed in the MFJ.

ultimately extended to this segment, which did not occur until about 1999.[57] Until that date, the BOCs were able to — and did — leverage their local service monopoly to diminish competition in, and maintain their dominance of, the adjacent intraLATA toll market.

36. BOC entry into the in-region *interLATA* long distance market creates precisely the same potential for anticompetitive conduct and market advantage as prevailed in the intraLATA market during the period between the 1984 Bell System break-up and the 1999 completion of intraLATA equal access. While the matter of call-by-call preemption (the 1+ dialing advantage) has been explicitly addressed through first the interLATA and then the intraLATA "equal access" requirement, the BOCs still maintain and benefit competitively from yet another — and fully comparable — form of preemptive access to their legacy local service customers — the "*inbound marketing channel*."

37. There is a clear and unmistakable analogy between the predivestiture/pre-equal access "1+ dialing" advantage and the post-271 "inbound marketing channel" advantage that the BOCs presently enjoy. Most customers do not have a real choice as to their local carrier, and customers overwhelmingly call the incumbent LEC first.[58] Most of these callers are likely not contacting the BOC for the purpose of ordering — or even inquiring about — the

57. 47 U.S.C. § 271(e)(2)(B) provides that "a state may not require a Bell operating company to implement intraLATA toll dialing parity in that State before a Bell operating company has been granted authority under this to provide interLATA services originating in that State or before 3 years after the date of enactment of the Telecommunications Act of 1996, whichever is earlier."

58. Indeed, a *Mover's Guide* distributed by the United States Postal Service to residential customers when they file a Change of Address notice advises them to "call your local phone company a month before you move" and then proceeds to list specifically the operating areas and phone numbers for BellSouth, Qwest and Verizon. See Attachment 4 to this Declaration.

BOC's long distance services where available. Most are calling to order new or additional *local* service, to change their existing service, report a service problem, inquire about a billing issue, order optional features, to move their service to a new location, or to obtain information about new local services that might become available, such as ADSL. Each of these *inbound* contacts provides the BOC with an *opportunity* to *sell* long distance service. And although initiated by the customer for a different purpose, each of these in-bound calls is, in the end, initiated by the caller with the intention of dealing in some manner with telephone service issues. As long as the BOCs maintain their position of overwhelming market dominance in the local market — which they do — customers will have a strong propensity to contact "the phone company" — the BOC or other incumbent LEC — for local phone service, and this propensity is particularly evident in the residential and small business segments.

38. Once the BOCs have been contacted by the customer regarding local service, they are permitted to preemptively suggest to the consumer that the BOC affiliate handle all of the customer's interLATA calls. A customer's selection of a carrier other than the BOC affiliate requires that the customer take additional, affirmative steps to make such a choice, and most likely, choose to initiate another phone call to the selected interLATA carrier in order to choose the appropriate discount calling plan. Just as in the intraLATA market, placing these additional burdens upon consumers who might otherwise elect to do business with a non-BOC long distance carrier will discourage customer choice and thereby place competing IXCs at a significant disadvantage vis-a-vis the BOC affiliate. The extent of this disadvantage can be illustrated by the fact that, in the states in which the BOCs have obtained in-region entry authority, BOC affiliates have amassed long distance market share at an unprecedented rate. The California PUC ALJ, speaking to this very point, observed that:

> We find that Pacific's proposed joint marketing plans, detailed above in relation to § 709.2(c)(3), also pose a substantial possibility of harm to the intrastate long distance telephone market. The significant advantage afforded Pacific's long distance affiliate by Pacific's ability to market its affiliate's service to several million incoming customer service calls per year from its existing local service customers will unquestionably affect the other interexchange carriers. No other interLATA competitor in California has any similar massive opportunity to address incoming calls from potential interLATA customers. PBLD's potentially swift dominance of the intrastate interexchange telephone market could detrimentally impact competition in that sector.[59]

39. Actual BOC market penetration results as reported by BOCs in states where in-region interLATA entry has been authorized demonstrate the dramatic and unprecedented success that the BOCs have achieved in capturing market share. After approximately twelve months following its receipt of Section 271 authority in New York, Verizon Long Distance reported a New York residential market share of 20%.[60] In addition, Verizon's New York long distance market penetration continued to grow at an impressive rate beyond the first year. After 21 months of providing long distance service in New York, Verizon reported a New York long distance market share of 31.7%, and at the end of 2001, after two full years of 271 authority, Verizon reported a market share of 34.2%.[61]

40. Verizon's experience in New York is not anomalous. Nine months after receiving 271 authority in Massachusetts, Verizon reported a long distance market share of more than

59. *California PUC Draft 271 Decision*, at 247.

60. See Verizon Press Release, "Verizon Communications Post Strong Results for Fourth Quarter and 2000," February 1, 2001.

61. Verizon Press Release, "Verizon Communications Reports Solid 3Q Earnings and Provides Outlook For Remainder of 2001," October 30, 2001; Verizon Press Release, "Verizon Communications Reports Solid Results For Fourth Quarter, Provides Outlook for 2002," January 31, 2002.

20%, and indicated that sales results for Pennsylvania, where Verizon began marketing long distance services in late October 2001, were in line with early success rates in other Verizon states.[62] In Texas, where SBC received interLATA authority in June of 2000, SBC reported that after less than nine months its long distance affiliate, SBCS, had acquired 2.1-million of SWBT's 10-million local customers, representing a 21% share of the long distance market in the state.[63] SBC subsequently stopped releasing long distance market share figures on a state-by-state basis, making further state-level analyses no longer possible.

41. The economic value of this preemption advantage enjoyed by BOC affiliates acquiring interLATA customers is graphically illustrated when one considers the speed and ability of OCCs to gain interLATA market share without similar preemptive advantages. The transition to interLATA equal access began in 1985 and was substantially complete by the end of 1988. The 1985 beginning of the transition to equal access can be thought of as the date at which the elimination of economic barriers to interLATA long distance entry began. That event is then analogous to the BOCs' initial satisfaction of the 14-point checklist which, presumably, eliminated the economic barriers to entry into the local market. But the consequences of these otherwise comparable policy initiatives have been dramatically different: By the end of the fifth year (*i.e.*, by the end of 1990) following the commencement of interLATA equal access, all of the non-AT&T IXCs *combined* had collectively acquired 22.92% of presubscribed lines nationwide,[64] even with the aid of such "jump-start" market development measures as "equal access balloting" and automatic assignment of nonresponding

62. *Id.*

63. *SBC Investor Briefing*, April 23, 2001, at 7.

64. Federal Communications Commission, Wireline Competition Bureau, Industry Analysis Division, *Long Distance Market Shares, Fourth Quarter 1998*, March, 1999, ("*Long Distance Market Share Report*"), Table 2.1.

subscribers to a non-AT&T carrier. Of course, what the OCCs did not have, but which the BOCs do, is the massive legacy customer base to exploit. It is thus not surprising that in just two years following its entry into the New York interLATA market, Verizon was able to capture 34.2% of its New York in-franchise local service customers, a level of market share that *no single OCC has ever reached*[65] and that took *all of the OCCs combined* some 10 years (following the 1985 commencement of equal access) to accomplish.[66]

42. Compounding the formidable competitive advantage that is available uniquely to BOCs through their exploitation of the "inbound marketing channel" is the fact that the "price" that the BOC long distance affiliate "pays" to the BOC for such joint marketing "services" is woefully short of fair market value and thus constitutes a *de facto* cross-subsidy flowing from the BOC's regulated ILEC services to the BOC's competitive long distance services. As the California PUC ALJ noted, maintenance of separate affiliate requirements is *critical* to the CPUC's ability to detect and ultimately remedy such practices:

> Pac-West/WA's costing discussion and comparison regarding the proposed joint marketing plan clearly demonstrates cross-subsidization, and we find it very troubling. We trust that Pacific will very carefully re-examine the cost elements of its proposed joint marketing plan to ensure full compliance with our rules. Moreover, we reaffirm the auditing requirements that we designed in D.99-02-013 for Pacific and PBLD's joint marketing arrangements. Our confidence in non-structural safeguards has waned significantly over the last few years. Thus, if our required audits uncover cost allocation improprieties in the final joint marketing agreements, we will not hesitate to take the strongest action.

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65. According to the most recent (2001) FCC IXC market share report, the largest non-AT&T IXC, MCI Worldcom, had a year-end 1999 residential market share of 16%, well below Verizon's two-year New York share of 34.2%. FCC Industry Analysis and Technology Division, *Statistics of the Long Distance Telephone Industry*, January 2001 (Data as of 1999), Table 24.

66. *Long Distance Market Share Report*, at Table 2.2.

> The record before us simply does not support the finding that there is no improper cross-subsidization anywhere within Pacific's proposal to provide long distance telephone service within California. Rather, the record includes documents that purport to show compliant costing allocations as well as documents that purport to show inappropriate allocations and underlying methodology. As of this date, the mandated audits have not yet been performed. However, we do find that our requirements for separate accounting records and for the examination of the cost allocation methodology for the provision of intrastate interexchange telecommunications service, pursuant to our affiliate transaction and cost allocation rules and O.P. 8 and 18 of D.99-02-013, will be integral in preventing, identifying and eliminating improper cross-subsidization.[67]

43. In view of the strong parallels between OCC entry in the 1980s and BOC entry today, I believe that the *results* of the earlier policy paradigm offer a useful and reasonable standard against which the current policy initiatives relative to BOC entry can be evaluated. That is, but for the BOCs' ability to exploit their inbound marketing channel, there is no *a priori* reason to expect their rate of market share growth to differ materially from that of the OCCs in the initial years following "equal access." Conversely, evidence of substantially greater BOC long distance market share growth serves to confirm the enormous value that Verizon and other BOCs obtain solely by virtue of their status as dominant local exchange carriers.

44. The extraordinary marketing advantage uniquely available to BOCs stemming from their use of the "inbound channel" has not been overlooked by Wall Street. As a February 8, 2001 Credit Suisse First Boston ("CSFB") report commented:

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67. *California PUC Draft 271 Decision*, at 242; footnotes omitted.

> We've been watching this industry for almost 20 years and we have never seen consumer share gained at the rate of VZ in NY and SBC in TX (the former 20% share in 12 mos and the latter 18% share in 6 months).[68]

When a BOC obtains Section 271 authority, it gets not simply the right to enter yet another isolated line of business, but the right to *integrate* local and long distance service into a single package, to make the two services essentially indistinguishable from the consumer's perspective, and to leverage its dominance of the local market to similarly come to dominate the long distance market as well.

45. It is abundantly apparent that the *entire foundation* of the BOCs' long distance entry strategy rests upon their ability to exploit the inbound marketing channel and their legacy relationships with existing BOC local service customers. *De facto*, and ultimately *de jure*, integration of the BOC local and long distance services regardless of the requirements of Section 272 is a critical element of this strategy. Lest there be any doubt about this, the Commission should recall that BOCs have been permitted into the *out-of-region* long distance market since the enactment of the 1996 *Act* (i.e., February 8, 1996). At that time, *BOCs were permitted to provide interLATA long distance service in all out-of-region states*.[69] However, *none of the RBOCs availed themselves of this opportunity* except with respect to certain out-of-region services, such as Calling Card services, that could be marketed to their *in-region* local service customers. Moreover, rather than compete out-of-region, both SBC and Bell Atlantic chose instead to *acquire* via merger out-of-region BOCs, expressly foregoing their

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68. "VZ: Analyst Mtg Provides Comprehensive '01 Outlook," Credit Suisse First Boston, 09:47am EST, 8-Feb-01 ("*Credit Suisse First Boston Report*").

69. Section 271(b)(2) provides that "A Bell operating company, or any affiliate of that Bell operating company, may provide interLATA services originating outside its in-region States after the date of enactment of the Telecommunications Act of 1996 ..."

opportunity for *immediate* long distance entry in those states but without the opportunity to leverage the ILEC subscriber base, for eventual long distance entry following Section 271 approval when they could pursue the fully integrated joint marketing strategy.

46. That SBC's marketing plans with respect to its long distance service are intimately linked to its legacy local service customer base is further confirmed by the fact that SBC's policy in its Section 271 states — Texas, Oklahoma, Kansas, Arkansas and Missouri — is to limit the availability of SBC long distance service to SBC local service customers only,[70] i.e., to not even offer or provide long distance service to customers of other ILECs or of CLECs. Thus, not only has SBC maintained its policy of not pursuing any out-of-region long distance entry, it does not even offer long distance service either to CLEC customers or to Independent ILEC customers *within the states in which SBC has received Section 271 authority*. Such revealed conduct compels the inescapable conclusion that the opportunity to engage in these practices appears to be the sole driver of SBC's interest in the long distance business. Credit Suisse First Boston makes the point profoundly clear in its comparison of (pre-merger) GTE's approach to selling long distance services through a separate CLEC affiliate vs. Verizon's and SBC's ability to offer long distance services directly to their ILEC customers:

> In stark contrast to Verizon's huge and quick 20% consumer LD share gains in NY State, LD subscribership was flat in the GTE franchise areas in '00 despite GTE's benefitting from similar pre-established branding and billing relationships. The difference is that GTE has not leveraged the inbound channel and also had been running its LD effort through its "CLEC", in effect forcing customers to switch to the GTE CLEC both their local service from GTE's ILEC and their LD service from another LD customer. Not very successful if you ask us and

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70. See Attachment 5 to this Declaration. This is a print-out of the response I received from the SBC website when I attempted to order SBC long distance service using a hypothetical telephone number in a Texas exchange not served by SWBT.

> certainly worthy of change given the empirical evidence that VZ's and SBC's use of the inbound channel and separate LD sub (but not bundled with local) have been extraordinarily successful.[71]

47. As the Credit Suisse First Boston report observes, this preemptive use of the "inbound channel" by both Verizon and SBC to "sell" their long distance service to *new* local service customers has been the principal explanation for their extraordinary success in acquiring customers in the first year in which they have been permitted into the long distance business. Indeed, SBC was sufficiently satisfied with its early market performance in Texas that after only seven months the company *increased* its interstate long distance rates by over 10%. As reported in the *Ft. Worth Star-Telegram*, February 2, 2001:

> Southwestern Bell announced it was raising the interstate rate on its flagship plan from 9 cents a minute to 10 cents a minute for new customers seven months after entering the long-distance market in Texas. Current subscribers will see no change in their domestic U.S. calling charges, said Shawn Ramsey, a San Antonio-based spokeswoman for Southwestern Bell, a unit of SBC Communications.
>
> Ramsey defended the increase, which doesn't require approval by the state's Public Utility Board, by saying the plan is superior to many offered by the major long-distance services. "We beat the pants off of them," she said. "We've got great rates any way you slice or dice it." Asked if the higher rate reflects a need to boost profits, she said: "We've been in the market about eight months now. We've learned a lot and made a number of changes that reflect what we've seen. And we've changed our plan accordingly."[72]

48. Indeed, at least with respect to these types of sales at the time of the initial local service contact, the BOC need spend little if any resources actually advertising or otherwise marketing its long distance services. The inbound caller has already made the contact with

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71. *Credit Suisse First Boston Report*.

72. "SW Bell raises interstate rate; current subscribers unaffected; PUC approval not needed," *Ft. Worth Star-Telegram*, February 2, 2001.

"the phone company" for basic telephone service and, unless that customer is a student of telecommunications industrial organization and regulation, he or she is as likely as not to accept the BOC's "recommendation" as the only and obvious choice.

A recent BOC-commissioned "study" claims that consumers will benefit from lower BOC long distance prices because BOCs with 271 authority are "profit-maximizing" across their access and retail toll services combined; if so, then the BOCs would be in violation both of access charge imputation rules as well as Section 272 separate affiliate requirements.

49. A recently released empirical study of Verizon and SBC pricing following their receipt of 271 authority in New York and Texas, respectively, suggests that in both instances the BOC ILEC entity and the Section 272 structurally separated long distance affiliate are not maintaining the "arm's length" relationship that is required by Section 272(b)(5) and, more generally, are operating vis-a-vis one another *as if the Section 272(a) and (b) structural separation requirements did not exist*. The study, "Does Bell Company Entry into Long-Distance Telecommunications Benefit Consumers?" by Jerry A. Hausman, Gregory K. Leonard, and J. Gregory Sidak,[73]("HLS") claims to have found "a statistically significant decrease of 8 to 12 percent in the average bill in states where BOC entry occurred as compared to the states without BOC entry."[74] I have examined the so-called empirical basis for the authors' various contentions and have identified a number of serious, indeed, fatal

73. Jerry A. Hausman, Gregory K. Leonard and J. Gregory Sidak, "The Consumer-Welfare Benefits from Bell Company Entry into Long-Distance Telecommunications: Empirical Evidence from New York and Texas" ("Hausman/Leonard/Sidak" or "HLS"), unpublished study, dated May 2002.

74. *Id.*, at 2.

deficiencies in their analysis.[75] Nevertheless, the study, which was commissioned by Qwest in support of its Section 271 applications,[76] advances a theoretical basis for the empirical results they claim to have obtained. If the authors' empirical findings and claims are accurate, however, the theoretical "double marginalization" explanation that they offer for this outcome would indicate that both Verizon in New York and SBC in Texas are in violation of the separate affiliate requirement.

50. Hausman *et al.* explain "double marginalization" as follows:

> Double marginalization occurs when two companies have a vertical supplier-customer relationship. The upstream company sets its margin to maximize its profits individually, while the downstream company does the same. If the upstream company begins to offer the downstream product also, it generally will set the final price of the downstream product to maximize its profits jointly. The company offering the combined product will often find that it can increase its profits by lowering the price of the final product below the combined price that would obtain in the previous situation.
>
> Suppose that a BOC's incremental margin on the provision of network access is $0.02 per minute, while the IXC's incremental margin on residential long-distance service is $0.04 per minute. The BOC will find it to be profit maximizing to lower the total margin from $0.06 per minute because it earns both margins, rather than only a single margin ($0.02 for access + $0.04 for long-distance = $0.06 total margin). The BOC would also be using two sets of

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75. Selwyn, Lee L., "BOC Long Distance Entry Does Not Benefit Consumers," presented at the Department of Justice Telecom Workshop, "*The Drivers and Significance of Competition in Local Telecommunications: Empirical Evidence*," Washington, DC, July 23, 2002. Available at www.econtech.com/library/doj_072302.pdf

76. Although the authors do not cite the source of their funding in the paper, evidence adduced in the current Section 271 proceeding in Minnesota has identified Qwest as that source. *In the Matter of a Commission Investigation into Qwest's Compliance with Section 271(d)(3)(C) of the Telecommunications Act of 1996 that the Requested Authorization is Consistent with the Public Interest Convenience and Necessity*, Before the Minnesota Public Utility Commission, PUC Docket No. P-421/CI-01-1373, Qwest response to DOC Information Request 18059.

> facilities, local access and long-distance facilities, to earn this higher margin. When the BOC decreases the price slightly, it sells more access and more long-distance services and earns approximately $0.06 per minute. In contrast, if an IXC decreases the price, it only receives the additional margin from increased sales of long-distance service of $0.04 per minute. Thus, the BOC has a greater incentive to charge lower long-distance prices than does an IXC. Furthermore, when the BOC lowers the long-distance price, the IXCs will lower their prices, which will increase the number of long-distance minutes demanded and consequently the number of access minutes demanded from the BOCs.

51. The adoption by Verizon and SBC of a "double marginalization" pricing strategy, as Hausman *et al* believe has occurred, belies the repeated claims by the RBOCs that they no longer have market power in the local exchange and access services markets. HLS observe that:

> Although the original example of double marginalization was in the case of monopoly, it is [sic] applies as well to imperfect competition, which characterizes telecommunications markets because of the large fixed and common costs. The Areeda-Hovenkamp antitrust treatise, for example, observes that "[t]he double marginalization model appears to make robust predictions that vertical integration results in increased output and lower prices any time the affected markets are something less than perfectly competitive." Under current regulatory policies, access and long-distance services are both sold at prices exceeding marginal (incremental) cost, so as to cover the large fixed costs of local and long-distance networks. Although access reform since the Telecommunications Act of 1996 has decreased the BOCs' access margin, it has not eliminated the entire margin. Thus, double marginalization still leads to the prediction that BOC entry into the in-region interLATA market will lead to lower long-distance prices. Our econometric findings support this economic analysis, which has not been taken into account by the DOJ and FCC in their section 271 implementation analyses.[77]

If the authors' empirical findings and claims as to "double marginalization" are accurate, this condition would indicate that both Verizon in New York and SBC in Texas are in violation of

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77. *HLS*, at 18, footnotes omitted.

both the Section 272(e)(3) imputation and the Section 272(a) and (b) separate affiliate requirements.

52. Moreover, such "double marginalization" will occur as between the BOC and its 272 affiliate *only when the two entities seek to maximize their joint profit* — i.e., when they explicitly *do not deal with each other at arm's length* as expressly required by Section 272(b)(5), and instead pursue a strategy that converts the "wall" that the *Act* sought to create between the BOC and long distance entities into a transparent and porous membrane whose purpose is entirely limited to serving as the perfunctory demarcation point for the required compliance postings and filings. The intent of the statute is to assure that the BOC's long distance affiliate gains no competitive advantage vis-a-vis nonaffiliated IXCs, which implies that it should view all payments to the BOC for both tariffed (e.g., access) and non-tariffed services as "costs" and make all pricing and output decisions without regard to the fact that such "payments" to the BOC will create offsetting profits in the BOC entity itself.

53. Consider, for example, the matter of the billing and collection services that are furnished by the BOC to the 272 affiliate. Where the 272 affiliate's customer is also a BOC local service customer (as I have noted, SBC's 272 long distance affiliate, SBCS, in fact, will *only* provide service to customers of the local SBC operating company[78]), the incremental cost to the consolidated enterprise of including a customer's long distance billing on the local service bill — which will need to be prepared and mailed, and the payment received and processed, whether or not the customer subscribes to the affiliate's long distance service — is

78. The SBC website indicates that "SBC Long Distance provides long distance where arrangements exist with local providers in the SBC Southwestern Bell Telephone Company service area. Queries to the cite indicate that this service is not available to CLEC customers. http:/www.SWBell.com/Products_Services/Residential/ProdInfo_1/1,1973,187--6-3-15,00.html

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extremely small. No additional envelope or postage will be required,[79] and the costs of receiving and processing a payment will be entirely unaffected whether or not the payment includes the long distance charges.

54. According to the Section 272(b)(5) disclosure information provided on Verizon's website, Verizon New York's charge to its Verizon Long Distance ("VLD") affiliate for billing and collection services is $1.15 per account (plus postage, which varied based on weight).[80] Since the incremental cost to VNY for these services is at or near zero, especially considering that postage is similar if not exactly the same were Verizon to bill only for local service, virtually all of the $1.15 "cost" to VLD represents "profit" to VNY; from the standpoint of the consolidated enterprise, then, any such "payments" by one entity to another are essentially a "wash" and can be ignored if Verizon is following a "maximizing joint profits" double marginalization strategy. By contrast, other long distance providers not affiliated with Verizon will incur real out-of-pocket costs for the billing and collection functions, whether purchased from Verizon at the same terms as are nominally being "offered" to VLD, or are accomplished via stand-alone billing and collection activities undertaken by the IXC.

55. The "double marginalization" theory also raises serious concerns as to BOC compliance with cost imputation requirements and the opportunities *and incentives* available to them to impose price squeezes on their rivals. If VNY/VLD and SWBT/SBCS pricing conduct is driven by the goal of maximizing joint profit, it is then necessary for the

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79. In most cases, only one or two additional pages of billing will need to be produced, and can be included in the same envelope with no additional postage.

80. http://www.verizonld.com/pdfs/VLDTransactionDetailWebPage1.pdf

downstream entity (VLD or SBCS) to essentially ignore any "payments" it makes to the upstream entity (VNY or SWBT) in setting its retail prices, and in fact to base those prices solely upon the underlying joint costs of both entities' services. Return to the HLS example where they posited that the access charge produces a $0.02 profit for the BOC entity and the retail long distance service produces a $0.04 "profit" relative to the downstream long distance affiliate entity's payment of access charges and incurrence of other costs. Now suppose that the two entities determine that the profit-maximizing price of the long distance service should be reduced by $0.02, bringing the per-minute joint profit to $0.04. Nonaffiliated IXCs would be forced to reduce their prices by a like amount in order to remain competitive, slashing their profit margins by 50% (i.e., from $0.04 to $0.02). They would still be forced to pay the full price of access to the BOC entity, which would continue to earn the full $0.02 access profit on all such purchases. Combining this with other "double marginalization" pricing and transactional incentives, such as billing and collection services and joint marketing, any semblance of "imputation" or "parity" in the pricing of services to nonaffiliated IXCs would be eradicated.

56. AT&T has alleged that SWB in Texas is ignoring access charges in exactly the manner described by HLS. Based in part on information provided as part of the requirement of Section 272(b)(5) that all affiliate transaction between the BOC and its Section 272 affiliate must be made at arm's length, reduced to writing, and made available for public inspection, AT&T filed a complaint with the Public Utility Commission of Texas on July 30, 2001 claiming that SBC and SBCS were engaging in exactly the type of double marginalization that HLS describe. As AT&T explains:

> When SWBT and SWB-LD sell intrastate switched long distance service at a rate of 6 cents per minute, the net revenue to SWB-LD, after paying SWBT's charges for switched access services, is approximately 0.33 cents per minute. However, based on public information in contracts between SWBT and SWB-LD

> filed on the SBC website, AT&T estimates that SWB-LD has a minimum of additional billing and marketing expenses of at least 3.4 cents per minute solely attributable to expenses incurred from affiliate transactions. In addition, SWBT and SWB-LD witness have filed sworn testimony at the FCC that indicates SWB-LD incurs an additional expense of 1-2 cents per minute for underlying carrier expenses. These expenses of at least 10-11 cents per minute cannot be fully recovered under SWB-LD's existing pricing structure. Moreover, it should be recognized that for certain rate plans, SWBT and SWB-LD explicitly recognize, and tout, that a customer's cost of SWBT and SWB-LD intrastate long distance telephone service can be less than a penny a minute-- significantly below the cost of switched access service alone. Based on the foregoing, AT&T respectfully submits that at least several of SWBT's and SWB-LD's current rates for intrastate long distance service, not to mention interstate long distance service, are below cost and predatory.

The facts offered by AT&T indicate that SWBT and SWB-LD have been violating the imputation requirements of Section 272(e)(3). Although Section 272(e)(3) is not covered by the sunset provision being considered by the Commission at the present, the information enabling AT&T to determine the existence of predatory pricing would no longer be available were this Commission to allow Section 272(a) and (b) to sunset.

57. If VLD was truly maintaining an arm's length, separate affiliate relationship with Verizon New York, it would be forced, when setting its own retail prices, to give effect to these account-specific payments to VNY as representing out-of-pocket *costs*. VNY would not, for example, be able to offer no-monthly-fee discount rate plans if it were subject to fixed per-account expenses. In fact, of course, VLD introduced precisely this type of pricing as soon as it was permitted to begin offering interLATA services in New York and has maintained this same pricing policy both in New York and in other Verizon 271 jurisdictions ever since. VLD and VNY are jointly behaving precisely as Hausman *et al.*'s "double marginalization" theory would suggest. Hence, it is not the "increased competition" resulting from VLD's long distance entry that brings prices down, it is the fact that the long distance and ILEC entities are acting *in concert* and not at arm's length, that they are working together

to maximize joint profit rather than their respective individual profits, that "explains" the empirical results that Hausman *et al.* claim to have identified. And it is precisely that type of *in concert* conduct that is expressly prohibited.

58. A graphic demonstration of the BOCs' potential ability to favor their own long distance business unit can be found in a "contract tariff" for switched access services that BellSouth recently introduced.[81] The discrimination is accomplished by tying a succession of "discounts" to "growth" in aggregate switched access usage over the five-year term of the contract tariff. As a new entrant into the in-region long distance market, the BOC affiliate starts out with minimal switched access demand, and thus will have little difficulty achieving a relatively high *rate* of growth. By contrast, the existing IXCs, some of which may be purchasing considerably more switched access service than the BOC affiliate will at the outset, are not likely to experience comparable *rates* of growth; indeed, to the extent that the BOC affiliate is successful in taking customers away from the IXCs, those IXCs may actually be experiencing *negative* growth. In any event, if the IXC is already purchasing quantities of switched access services that exceed the upper bound of the discount range — 4,401,406,922 minutes in the case of BellSouth's tariff — the putatively "available" discount price would as a practical matter not be available to carriers other than the BOC affiliate.[82] The effect of this growth-driven pricing device is ultimately to afford the BOC long distance affiliate lower rates than would be available to other IXCs with which it competes. Of course, if the

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81. BellSouth Telecommunications, Inc., FCC No. 1, 520th Revised Page 1, 8th Revised Page 9.0.9, Effective May 18, 2002.

82. I have no specific knowledge that BellSouth Long Distance, the BellSouth Section 272 affiliate, is actually purchasing switched access services out of this contract tariff. However, the *fact* that this type of tariff has been introduced serves to demonstrate the *opportunity* that a BOC would have to favor its affiliate in the guise of a generally available tariff offering.

separate affiliate requirement is allowed to sunset, the BOC's long distance business unit (which may then be formally integrated into the BOC ILEC entity) will no longer be required to "buy" tariffed switched access services at all, and will instead be allowed simply to utilize the BOC's network access resources subject only to the far more malleable "imputation" requirement of Section 272(e)(3).

59. Importantly, if the separate affiliate requirement is allowed to sunset and the Section 272(b)(1) "operate independently" and 272(b)(5) "arm's length" requirements are eliminated, BOCs will no longer be under any obligation to "sell" access services to their long distance business units at tariff rates. The sole remaining "safeguard" against discrimination with respect to access services will be Section 272(e)(3), which is not subject to the sunset provision. Section 272(e)(3) requires the BOC to "... impute to itself (if using the access for its provision of its own services), an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service." "Imputation" requirements of this type are applied by state commissions in the case of ILEC-provided competitive *intraLATA* toll services, but due to the absence of explicit access charges, precise application of such rules is particularly difficult. ILECs have argued, for example, that they are free to aggregate different services together in demonstrating that the imputation requirement has been satisfied, which may permit certain services to be priced below the imputation level only to be offset (i.e., cross-subsidized) by others whose prices exceed the applicable access charges. Such contentions have been rejected by state commissions,[83] but only after the practice had been underway for some

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83. *See, e.g. Application of Qwest Corporation for an Increase in Revenues,* Oregon Public Utilities Commission, Order no. 01-810, 2001 Ore. PUC LEXIS 449, September 14, 2001, (order unpaginated, at "Access Charge Imputation" section), and *Application of US West Communications, Inc., for the Commission to Open an Investigatory Docket to Eliminate on*

(continued...)

time and following often protracted litigation. Proper application of an imputation requirement such as that contained at Section 272(e)(3) would require the BOC to demonstrate that its retail price exceeds the sum of the imputed access charges together with all costs incident to the value-added (long distance) services of which those access services are a component. Short of protracted complaint proceedings, I am not aware of any remaining mechanism, once the separate affiliate requirement has been permitted to sunset, that would permit the Commission or affected competitors to verify compliance with Section 272(e)(3).

60. As another example of joint BOC/affiliate pricing actions whose effect is to create a price squeeze for competing providers, consider the types of "tie-in" arrangements that Verizon Long Distance and Verizon New York have pursued as part of their "joint marketing" program. In New York, Verizon Long Distance ("VLD") was offering a $4.60 "credit" when a customer selected the basic VLD Schedule "C" ($0.10 per minute, no minimum, no monthly charge) calling plan and also subscribed to *Verizon New York*'s "Value Pack" service, a package of local exchange service and selected vertical features.[84] The VLD Schedule C rate plan was targeted at the relatively low-use customer who would be attracted by the absence of either a monthly charge or minimum usage commitment. If, for example, such a customer were to make no long distance calls at all during a given month, VLD would sustain a "loss" of at least $4.60 in that it would still have to "pay" the credit to

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83. (...continued)
an Expedited Basis the Requirements that US West Impute Switched Access Rates into the Price Floor of its IntraLATA Long Distance Service, Colorado Public Utilities Commission, Docket No. 00A-201T, 2001 Colo. PUC LEXIS 133, January 24, 2001, at *16.

84. Bell Atlantic Communications, Inc. d/b/a Verizon Long Distance, New York PSC Tariff No. 1, Original Promotional Attachment No. 5. Package No. 1 Promotion and Rate Schedule (Section 3.5.3).

Verizon New York while receiving no offsetting long distance revenue from the customer. Verizon New York, however, would realize $17.99 in actual revenues from the customer (the price of Value Pack service)[85] plus the additional $4.60 "payment" from Verizon Long Distance. VNY gains $22.59 while VLD "loses" $4.60, which still results in a net gain to the consolidated Verizon bottom line of $17.99, erasing the VLD "loss" when examined at the enterprise level. VLD's ability to offer this "promotion" and to potentially sustain the "losses" arising therefrom is solely and uniquely attributable to its affiliate relationship with the Verizon BOC. Verizon has just announced the availability in its Section 271 states of several new "packages" of local, long distance and DSL services under the brand name "Veriations[SM]" that offer discounts of up to $15 if the customer orders a package consisting of local service with unlimited intraLATA calling, 14 custom calling features, DSL and Verizon (interLATA) Long Distance.[86] It's not clear how this $15 discount will be allocated as between the VNY and VLD entities, but from the standpoint of the parent company, it doesn't actually matter.

61. Of course, from the perspective of any *competing* non-affiliated interexchange carrier attempting to make a comparable "promotional" offer, it certainly does matter. That same $4.60 "credit" (and whatever new "credit" is associated with the *Veriations*[SM] package) would be a real *cash payment*, representing a true out-of-pocket cost to the IXC. In Verizon's case, even though the inter-affiliate "payment" is (presumably) actually being recorded on the two entities' respective books, VLD is behaving as if no such "payment" is actually taking place.

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85. http://www22.verizon.com/foryourhome/SAS/StateSelector.asp?ID=choosefeat, accessed 07/23/2002.

86. Verizon News Release, "Verizon Adds DSL to High Value Service Bundle," July 23, 2002.

The effect of these "promotional" or "tie-in" offers is to impose an anticompetitive price squeeze on VLD's long distance rivals.

The integrated relationship between the BOC and its Section 272 Affiliate is also reflected in distorted inter-affiliate pricing related to joint marketing of local and long distance services.

62. Verizon New York's provision of "joint marketing" services to VLD, the 272 affiliate, provides perhaps an even more compelling example of conduct whose effect is to ignore the nominal existence of the separate long distance affiliate. A BOC's authority to engage in joint marketing of its own local services with its affiliate's long distance service is found at Section 272(g)(3) of the federal *Act*, which operates to exempt a BOC's joint marketing of local and long distance service from the broader nondiscrimination requirements of Section 272(c):

> 272(g)(3): RULE OF CONSTRUCTION- The joint marketing and sale of services permitted under this subsection shall not be considered to violate the nondiscrimination provisions of subsection (c).

The Section 272(g)(3) joint marketing carve-out, however, is limited solely to the "nondiscrimination provisions" of Section 272(c), which is found at 272(c)(1), and does not exempt such joint marketing activities from 272(c)(2), which requires that a Bell operating company

> shall account for all transactions with an affiliate described in subsection (a) in accordance with accounting principles designated or approved by the Commission.

Nothing in subsection 272(g)(3) in any way exempts a BOC or its section 272(a) interLATA affiliate from the requirements of Section 272(b).

63. Disclosures and postings that Verizon and SBC have been required to make with respect to Section 272(b) affiliate transactions confirm that there are extensive and uncompensated information flows going from the BOC entity to the long distance affiliate, and that the affiliate is not being required to pay the BOC entity anything remotely close to the full and fair market value of such information and for the services that it receives from the BOC. In addition to furnishing personnel to support the joint marketing function, Verizon New York also provides its long distance affiliate with unfettered access to VNY's customer base and to the *inbound* customer-initiated contacts that arise as a consequence of VNY's dominant control of the New York residential local service market. Competing long distance providers must engage in extensive advertising, direct mail, and telemarketing to promote their service, and do not get anywhere near the quantity of inbound customer contacts as does the BOC, and those which IXCs do receive are primarily the result of the IXCs' advertising and other promotional efforts, undertaken at not inconsiderable cost to those IXCs.

64. Customer acquisition is among the most costly aspects of an interexchange carrier's operation. Without the benefit of the embedded ubiquitous customer base that is uniquely available to VLD, other IXCs must pursue active marketing strategies involving extensive media advertising, telemarketing, direct mail, and special promotions (cash, airline miles, etc.). When spread over the number of sales that are actually consummated, these costs can amount to hundreds of dollars per customer acquired. I am aware of at least one analysis that has put such cost at "up to $300 to $600 in sales support, marketing and commissions" per customer acquired.[87] The prevailing industry customer acquisition cost represents the fair market value of the customer acquisition services that a BOC provides to its 272 affiliate.

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87. See Borna, Claude, "Combating Customer Churn," in *Business and Management Practices,* Vol. 11, No. 3; Pg. 83-85; ISSN: 0278-4831, Horizon House Publications, Inc., Telecommunications Americas Edition (March, 2000).

Yet according to Verizon's 272(b)(5) disclosures, VLD's "payments" to VNY for customer acquisition/joint marketing services are only $7.71 per contact;[88] SBC has identified the amount of such charges by its Texas BOC, SWBT, to the SBCS long distance affiliate at $9.90 per acquisition.[89] The magnitude of such payments is woefully short of the fair market value of these services and of the customer information that is being beneficially furnished by the BOCs to their affiliates. Through its use of the joint marketing channel, Verizon LD is able to save hundreds of dollars in marketing costs per customer.

65. Verizon and SBC improperly price joint marketing services using Fully Distributed Cost methodologies instead of Fair Market Value. The Commission explicitly requires that BOCs price all services provided to their Section 272 Affiliate that are not subject to tariff or Prevailing Company Pricing, at the higher of fair market value or fully distributed cost. Should the service not be available on the open market, this Commission required that a BOC *estimate* a fair market value.[90] Yet instead of the conducting the required study and estimating the inbound channel's value, Verizon presented the Section 272 Auditors with a

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88. http://www.verizonled.com/pdfs/exhibit46zhamendment34.pdf

89. http://www.sbc.com/public_affairs/regulatory_documents/affiliate_agreements/300-993pa5-02.xls, accessed 7/25/2002.

90. In its *Accounting Safeguards Order,* at 17610, the Commission sets forth "the baseline for a good faith determination of fair market value by requiring carriers to use methods that are routinely used by the general business community." The Commission anticipated that some services would be unique and found, "[w]hen situations arise involving transactions that are not easily valued by independent means, we require carriers to maintain records sufficient to support their value determination." Finally, the Commission notes, "nothing discussed here exempts carriers from their statutory obligation under section 220(c) to justify their accounting entries."

letter stating that "FMV could not be obtained for these services."[91] Moreover, Verizon failed to explain why it did not obtain an *estimate* of the fair market value for these services.

66. It is instructive to compare and contrast Verizon's inter-entity pricing practices as between billing and collection services, on the one hand, and customer acquisition/joint marketing services, on the other. Since VNY offers and in fact provides billing and collection services to nonaffiliated IXCs, it is required to "charge" the same price for such services to its Section 272 affiliate as it does with respect to equivalent services furnished to nonaffiliated entities.[92] Not surprisingly, VNY's "price" for these services has been set at "fair market value," well in excess of its actual incremental cost. By contrast, VNY is *not* required to provide "joint marketing" services to nonaffiliated IXCs,[93] and by extension is not required to "offer" comparable or nondiscriminatory terms and conditions with respect to such services to nonaffiliated entities. Not surprisingly, VNY prices these services at what it claims to be fully-distributed cost ("FDC"),[94] resulting in a per-transaction "price" of only $7.71, a minute fraction of the fair market value of the customer acquisition services that it provides to VLD.

67. There is thus no evidence that the dollar amounts being reflected on the two entities' books bear any resemblance to the proper valuation of the services being provided, i.e., the

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91. Verizon Communications Inc. Section 272 Biennial Agreed-Upon Procedures Engagement, filed in *Implementation of the Telecommunications Act of 1996: Accounting Safeguards Under the Telecommunications Act of 1996*, CC Docket No. 96-150, Filed February 6, 2002, Appendix A at 21.

92. 47 U.S.C. § 271(c)(1).

93. 47 U.S.C. § 272(g).

94. *Supra*, footnote 88.

amounts that firms dealing with each other on a truly arm's length basis would demand. The conduct of VNY/VLD and SWBT/SBCS transitions are, indeed, consistent with the "double marginalization" theory, and *inconsistent* with any finding that anything beyond "lip-service" is being afforded by either RBOC to the Section 272(a) and (b) separate affiliate requirements.

The Section 272 separate affiliate requirement provides an essential transition between the former BOC long distance line-of-business restriction and a possible future in which the BOCs' market power with respect to local telecommunications access and services will have been eroded by the arrival of effective competition.

68. Section 271 was adopted as a *replacement* for the MFJ long distance line of business restriction, and established a process by which BOCs could enter the "in-region" long distance market provided that they implemented a series of specific measures that were to have the effect of irreversibly opening their previously monopolized local telecommunications markets to competitive entry. To the extent that the *local* market itself becomes competitive, the BOCs' ability to exert market power in the adjacent long distance market would be attenuated. Conversely, however, to the extent that competition *fails to develop* in the local services market, the BOC will then have both the incentive and the ability to exert market power in, and ultimately to remonopolize, the adjacent long distance market.

69. Since the MFJ, competition in the long distance market has thrived — and as a result prices have sharply decreased — in the nearly two decades since the MFJ first went into effect in January, 1984. The principle generally underlying Section 271 is that once there is sufficient competition in the *local* service market, it will then no longer be possible for a BOC to extend its local monopoly into the adjacent long distance market. The existence of but a *single* facilities-based competitor somewhere in any state — one of the threshold

conditions that a BOC must satisfy to obtain Section 271 approval[95] — is clearly not by itself sufficient to constrain the incumbent BOC's exercise of market power.

70. Congress established the Section 272 separate affiliate requirement and, in particular, the 272(b)(1) "operate independently" and 272(b)(5) "arm's length" provisions, specifically to wall-off the BOC ILEC and IXC entities from acting in concert to the detriment of long distance competitors. For so long as the BOCs maintain market power with respect to local services and local network access, they retain both the ability and the incentive to exploit preexisting customer relationships and the "inbound marketing channel" with respect to new customers to direct and to divert customers to their long distance offerings.

As a result of the BOCs' local market power, CLECs are unable to enjoy the same "double marginalization" benefits, a factor that ensures the BOCs and their affiliates will be able to expand their already substantial long distance market share to monopoly levels.

71. Verizon and SBC's ability to gain significant long distance market share is undoubtedly due to their local market power. As I have discussed above, the pricing plans offered by the BOC Section 272 affiliates are premised upon the ability of the BOC and its Section 272 affiliate to operate as if interaffiliate payments for fixed costs such as billing did not exist. Virtually all marketing costs associated with customer acquisition were avoided by the Section 272 affiliate, despite the clear requirement of Section 272(b)(5) that the BOC marketing services should have resulted in arm's length marketing fees paid by the 272 affiliate to the BOC. Avoiding these costs is the only economic reason why the BOC interLATA affiliates are able to offer pricing plans such as their no-minimum, no-monthly fee offer.

95. 47 U.S.C § 271(c)(1)(A).

72. BOC local market power allows integrated offers that simply are not possible for competitors to match. As the default local service provider, the BOC does not need to engage in additional advertising or customer acquisition costs to attract local customers, and once the local customers are acquired, the BOC is allowed to preemptively sell the customer the affiliate's long distance service. Even assuming that a CLEC were able to attract a market share approaching that of the BOCs, the CLEC's relatively new position in the local market does not allow the CLEC to enjoy similar cost avoidance. While a CLEC's long distance service would enjoy similar customer acquisition and billing benefits as the BOC affiliate, the CLEC's *local* service provision would be required to incur massive marketing outlays in order to attract local customers, at costs that are likely to be similar to or higher than those required to attract long distance customers. Those marketing costs, unique to CLECs, would increase the CLECs' cost of providing service above that of the BOC.

73. The purpose of Section 272 was to prevent exactly this kind of integrated pricing until CLECs were similarly positioned to take advantage of the same type of economies. CLECs will not be so positioned until the BOC no longer enjoys market power in the local market. As long as the BOC is permitted to exploit its captive relationship with the vast majority of local service customers to market and sell its affiliate's long distance services, BOC long distance shares will grow rapidly and non-BOC IXCs will suffer a precipitous decline in customers and demand. Faced with such losses, IXC costs will rise and at least some IXCs will be forced to exit the business, further exacerbating the situation and affording the BOCs an opportunity to remonopolize the nation's long distance market.

Conclusion

74. The Section 272(a) and (b) separate affiliate requirement and the Section 272(c) and (e) nondiscrimination requirements were included in the 1996 *Act* specifically to limit the BOCs' ability, following their receipt of Section 271 in-region interLATA authority, to leverage their market power in local exchange and access services into the adjacent and competitive long distance market. The BOCs' market power with respect to local exchange and access services has not materially diminished since the February 1996 date of enactment. The need to wall-off the BOCs' competitive long distance entity from their largely monopolistic local service operation is as strong and important today as it was six years ago and, if anything, there is now a compelling need to *strengthen* the Section 272(b) structural separation requirements in light of actual "on the ground" experience with BOC in-region long distance activities. To the extent that, by virtue of their continuing dominance of the market for local and access services, the BOCs can continue to operate the two nominally separate entities as if they were fully integrated, to pursue pricing and marketing strategies that are designed to maximize joint profit, to ignore imputation requirement, to impose price squeezes upon competing CLECs and IXCs, and to cross-subsidize their long distance business by failing to compensate monopoly local service ratepayers for the value that the long distance business gains from inter-affiliate transfers, the prospect of near-total and rapid remonopolization by the BOCs of the nation's long distance market is quite real.

75. Congress established the Section 272 separate affiliate and nondiscrimination requirements and, in particular, the Section 272(b)(1) "operate independently," 272(b)(5) "arm's length," and Section 272(e)(3) "imputation" provisions, specifically to prevent the BOC ILEC and IXC entities from acting in concert to the detriment of long distance competitors. Section 272 was designed to prevent collusive, discriminatory and exclusionary practices by a BOC in

the operation of its long distance business until CLECs were similarly positioned to take advantage of the same type of integration economies. CLECs will not be so positioned until the BOC no longer enjoys market power in the local market. As long as BOCs are permitted to exploit captive relationships with the vast majority of local service customers to market and sell long distance services, BOC long distance shares will grow rapidly and non-BOC IXCs will suffer a precipitous decline in customers and demand. Faced with such losses, IXC costs will rise and at least some IXCs will be forced to exit the business, further exacerbating the situation and affording the BOCs an opportunity to remonopolize the nation's long distance market.

76. While the Section 272 separate affiliate requirement cannot *guarantee* that BOCs will not engage in cross-subsidization, discrimination, price squeezes or other anticompetitive conduct, the retention of the separation requirement clearly makes such behavior somewhat more difficult and in any event facilitates its *detection*. It is critical that the Commission retain — and strengthen — the separate long distance affiliate requirement until such time as the BOC no longer dominates the local service market in the geographic area and consumer or business market in which it provides service.

The foregoing statements are true and correct to the best of my knowledge, information and belief.

LEE L. SELWYN

Attachment 1

Statement of Qualifications

DR. LEE L. SELWYN

Dr. Lee L. Selwyn has been actively involved in the telecommunications field for more than twenty-five years, and is an internationally recognized authority on telecommunications regulation, economics and public policy. Dr. Selwyn founded the firm of Economics and Technology, Inc. in 1972, and has served as its President since that date. He received his Ph.D. degree from the Alfred P. Sloan School of Management at the Massachusetts Institute of Technology. He also holds a Master of Science degree in Industrial Management from MIT and a Bachelor of Arts degree with honors in Economics from Queens College of the City University of New York.

Dr. Selwyn has testified as an expert on rate design, service cost analysis, form of regulation, and other telecommunications policy issues in telecommunications regulatory proceedings before some forty state commissions, the Federal Communications Commission and the Canadian Radio-television and Telecommunications Commission, among others. He has appeared as a witness on behalf of commercial organizations, non-profit institutions, as well as local, state and federal government authorities responsible for telecommunications regulation and consumer advocacy.

He has served or is now serving as a consultant to numerous state utilities commissions including those in Arizona, Minnesota, Kansas, Kentucky, the District of Columbia, Connecticut, California, Delaware, Maine, Massachusetts, New Hampshire, Vermont, New Mexico, Wisconsin and Washington State, the Office of Telecommunications Policy (Executive Office of the President), the National Telecommunications and Information Administration, the Federal Communications Commission, the Canadian Radio-television and Telecommunications Commission, the United Kingdom Office of Telecommunications, and the Secretaria de Comunicaciones y Transportes of the Republic of Mexico. He has also served as an advisor on telecommunications regulatory matters to the International Communications Association and the Ad Hoc Telecommunications Users Committee, as well as to a number of major corporate telecommunications users, information services providers, paging and cellular carriers, and specialized access services carriers.

Dr. Selwyn has presented testimony as an invited witness before the U.S. House of Representatives Subcommittee on Telecommunications, Consumer Protection and Finance and before the U.S. Senate Judiciary Committee, on subjects dealing with restructuring and deregulation of portions of the telecommunications industry.

In 1970, he was awarded a Post-Doctoral Research Grant in Public Utility Economics under a program sponsored by the American Telephone and Telegraph Company, to conduct research on the economic effects of telephone rate structures upon the computer time sharing industry. This work was conducted at Harvard University's Program on Technology and Society, where he was appointed as a Research Associate. Dr. Selwyn was also a member of the faculty at the College of Business Administration at Boston University from 1968 until 1973, where he taught courses in economics, finance and management information systems.

Dr. Selwyn has published numerous papers and articles in professional and trade journals on the subject of telecommunications service regulation, cost methodology, rate design and pricing policy. These have included:

"Taxes, Corporate Financial Policy and Return to Investors"
National Tax Journal, Vol. XX, No.4, December 1967.

"Pricing Telephone Terminal Equipment Under Competition"
Public Utilities Fortnightly, December 8, 1977.

"Deregulation, Competition, and Regulatory Responsibility in the Telecommunications Industry"
Presented at the 1979 Rate Symposium on Problems of Regulated Industries - Sponsored by: The American University, Foster Associates, Inc., Missouri Public Service Commission, University of Missouri-Columbia, Kansas City, MO, February 11 - 14, 1979.

"Sifting Out the Economic Costs of Terminal Equipment Services"
Telephone Engineer and Management, October 15, 1979.

"Usage-Sensitive Pricing" (with G. F. Borton)
(a three part series)
Telephony, January 7, 28, February 11, 1980.

"Perspectives on Usage-Sensitive Pricing"
Public Utilities Fortnightly, May 7, 1981.

"Diversification, Deregulation, and Increased Uncertainty in the Public Utility Industries"
Comments Presented at the Thirteenth Annual Conference of the Institute of Public Utilities, Williamsburg, VA - December 14 - 16, 1981.

"Local Telephone Pricing: Is There a Better Way?; The Costs of LMS Exceed its Benefits: a Report on Recent U.S. Experience."
Proceedings of a conference held at Montreal, Quebec - Sponsored by Canadian Radio-Television and Telecommunications Commission and The Centre for the Study of Regulated Industries, McGill University, May 2 - 4, 1984.

"Long-Run Regulation of AT&T: A Key Element of A Competitive Telecommunications Policy"
Telematics, August 1984.

"Is Equal Access an Adequate Justification for Removing Restrictions on BOC Diversification?"
Presented at the Institute of Public Utilities Eighteenth Annual Conference, Williamsburg, VA - December 8 - 10, 1986.

"Market Power and Competition Under an Equal Access Environment"
Presented at the Sixteenth Annual Conference, "Impact of Deregulation and Market Forces on Public Utilities: The Future Role of Regulation" Institute of Public Utilities, Michigan State University, Williamsburg, VA - December 3 - 5, 1987.

"Contestable Markets: Theory vs. Fact"
Presented at the Conference on Current Issues in Telephone Regulations: Dominance and Cost Allocation in Interexchange Markets - Center for Legal and Regulatory Studies Department of Management Science and Information Systems - Graduate School of Business, University of Texas at Austin, October 5, 1987.

"The Sources and Exercise of Market Power in the Market for Interexchange Telecommunications Services"
Presented at the Nineteenth Annual Conference - "Alternatives to Traditional Regulation: Options for Reform" - Institute of Public Utilities, Michigan State University, Williamsburg, VA, December, 1987.

"Assessing Market Power and Competition in The Telecommunications Industry: Toward an Empirical Foundation for Regulatory Reform"
Federal Communications Law Journal, Vol. 40 Num. 2, April 1988.

"A Perspective on Price Caps as a Substitute for Traditional Revenue Requirements Regulation"
Presented at the Twentieth Annual Conference - "New Regulatory Concepts, Issues and Controversies" - Institute of Public Utilities, Michigan State University, Williamsburg, VA, December, 1988.

"The Sustainability of Competition in Light of New Technologies" (with D. N. Townsend and P. D. Kravtin)
Presented at the Twentieth Annual Conference - Institute of Public Utilities Michigan State University, Williamsburg, VA, December, 1988.

"Adapting Telecom Regulation to Industry Change: Promoting Development Without Compromising Ratepayer Protection" (with S. C. Lundquist)
IEEE Communications Magazine, January, 1989.

"The Role of Cost Based Pricing of Telecommunications Services in the Age of Technology and Competition"
Presented at National Regulatory Research Institute Conference, Seattle, July 20, 1990.

"A Public Good/Private Good Framework for Identifying POTS Objectives for the Public Switched Network" (with Patricia D. Kravtin and Paul S. Keller)
Columbus, Ohio: *National Regulatory Research Institute*, September 1991.

"Telecommunications Regulation and Infrastructure Development: Alternative Models for the Public/Private Partnership"
Prepared for the Economic Symposium of the International Telecommunications Union Europe Telecom '92 Conference, Budapest, Hungary, October 15, 1992.

"Efficient Infrastructure Development and the Local Telephone Company's Role in Competitive Industry Environment" *Presented at the Twenty-Fourth Annual Conference, Institute of Public Utilities, Graduate School of Business, Michigan State University, "Shifting Boundaries between Regulation and Competition in Telecommunications and Energy"*, Williamsburg, VA, December 1992.

"Measurement of Telecommunications Productivity: Methods, Applications and Limitations" (with Françoise M. Clottes)
Presented at Organisation for Economic Cooperation and Development, Working Party on Telecommunication and Information Services Policies, '93 Conference "Defining Performance Indicators for Competitive Telecommunications Markets", Paris, France, February 8-9, 1993.

"Telecommunications Investment and Economic Development: Achieving efficiency and balance among competing public policy and stakeholder interests"
Presented at the 105th Annual Convention and Regulatory Symposium, National Association of Regulatory Utility Commissioners, New York, November 18, 1993.

"The Potential for Competition in the Market for Local Telephone Services" (with David N. Townsend and Paul S. Keller)
Presented at the Organization for Economic Cooperation and Development Workshop on Telecommunication Infrastructure Competition, December 6-7, 1993.

"Market Failure in Open Telecommunications Networks: Defining the new natural monopoly," *Utilities Policy*, Vol. 4, No. 1, January 1994.

The Enduring Local Bottleneck: Monopoly Power and the Local Exchange Carriers, (with Susan M. Gately, et al) a report prepared by ETI and Hatfield Associates, Inc. for AT&T, MCI and CompTel, February 1994.

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The Effect of Internet Use On The Nation's Telephone Network, Lee L. Selwyn and Joseph W. Laszlo, a report prepared for the Internet Access Coalition, July 22, 1997.

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Broken Promises: A Review of Bell Atlantic-Pennsylvania's Performance Under Chapter 30, Lee L. Selwyn, Sonia N. Jorge and Patricia D. Kravtin, Economics and Technology, Inc., June 1998.

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Dr. Selwyn has been an invited speaker at numerous seminars and conferences on telecommunications regulation and policy, including meetings and workshops sponsored by the National Telecommunications and Information Administration, the National Association of

Regulatory Utility Commissioners, the U.S. General Services Administration, the Institute of Public Utilities at Michigan State University, the National Regulatory Research Institute at Ohio State University, the Harvard University Program on Information Resources Policy, the Columbia University Institute for Tele-Information, the International Communications Association, the Tele-Communications Association, the Western Conference of Public Service Commissioners, at the New England, Mid-America, Southern and Western regional PUC/PSC conferences, as well as at numerous conferences and workshops sponsored by individual regulatory agencies.

Attachment 2

Statistical Analysis of CLEC Penetration Rates as a Function of BOC Long Distance Entry

ECONOMICS AND TECHNOLOGY, INC.

Data Used in Regression Analyses

State	CLEC Residential Retail Market Share	Percent of CLEC Lines that are Facilities-based	CLEC Residential Facilities Based Market Share	ILEC in LD market 0=No 1=Yes
Alabama	0.48%	84.93%	0.07%	0
Alaska	0.00%	0.00%	0.00%	0
Arizona	5.79%	47.32%	3.05%	0
Arkansas	0.00%	0.00%	0.00%	1
California	4.26%	54.58%	1.94%	0
Colorado	9.71%	56.13%	4.26%	0
Connecticut	3.87%	51.27%	1.88%	1
Delaware	0.00%	0.00%	0.00%	0
District of Columbia	9.25%	36.59%	5.86%	0
Florida	2.80%	69.98%	0.84%	0
Georgia	7.62%	72.09%	2.13%	1
Hawaii	0.00%	0.00%	0.00%	1
Idaho	0.00%	0.00%	0.00%	0
Illinois	12.63%	65.17%	4.40%	0
Indiana	1.73%	63.27%	0.64%	0
Iowa	8.53%	82.16%	1.52%	0
Kansas	7.02%	83.00%	1.19%	1
Kentucky	0.00%	0.00%	0.00%	0
Louisiana	0.52%	76.91%	0.12%	1
Maine	0.00%	0.00%	0.00%	1
Maryland	1.59%	81.31%	0.00%	0
Massachusetts	10.59%	52.56%	5.02%	1
Michigan	10.21%	86.97%	1.33%	0
Minnesota	6.38%	79.61%	1.30%	0
Mississippi	2.25%	86.52%	0.30%	0
Missouri	3.84%	85.97%	0.54%	1
Montana	0.00%	0.00%	0.00%	0
Nebraska	10.67%	37.06%	6.72%	0
Nevada	0.00%	0.00%	0.00%	0
New Hampshire	7.67%	49.53%	3.87%	0
New Jersey	1.55%	78.50%	0.33%	1
New Mexico	0.00%	0.00%	0.00%	0
New York	22.48%	79.67%	4.57%	1
North Carolina	0.89%	76.91%	0.21%	0
North Dakota	0.00%	0.00%	0.00%	0
Ohio	1.30%	59.08%	0.53%	0
Oklahoma	4.28%	44.34%	2.38%	1
Oregon	2.95%	79.83%	0.59%	0
Pennsylvania	9.93%	56.85%	4.28%	1
Rhode Island	13.48%	43.07%	7.68%	1
South Carolina	1.52%	90.61%	0.14%	0
South Dakota	0.00%	0.00%	0.00%	0

Tennessee	1.44%	65.56%	0.49%	0
Texas	11.27%	80.87%	2.16%	1
Utah	8.52%	53.57%	3.96%	0
Vermont*	0.23%	36.76%	0.14%	1
Virginia	11.09%	62.16%	4.20%	0
Washington	5.00%	53.74%	2.31%	0
West Virginia	0.00%	0.00%	0.00%	0
Wisconsin	4.57%	86.16%	0.63%	0
Wyoming	0.00%	0.00%	0.00%	0

Source: FCC, Wireline competition Bureau, Industry Analysis and Technology Division, *Local Competition Report* , Rel. July 23, 2002, at Tables 6, 8, and 9. Averages are weighted by total residential lines. States designated by IATD with CLEC penetration levels too small to maintain firm confidentiality are included as 0%. Facilities-based percentage is for total CLEC lines, however, since CLECs more commonly serve residential lines via UNE or resale arrangements, the CLEC facilities-based residential share figures likely overstate actual CLEC facilities-based residential shares. Data for Vermont is taken from Application by Verizon New England, Inc., et al, for Authorization To Provide In-Region, InterLata Services in Vermont, WC Docket No. 02-7, Verizon Brief, filed January 17, 2002, at 7

SUMMARY OUTPUT **CLEC Residential Retail Market Share**

Regression Statistics	
Multiple R	0.217363761
R Square	0.047247005
Adjusted R Square	0.027803066
Standard Error	0.048736654
Observations	51

ANOVA

	df	SS	MS	F	Significance F
Regression	1	0.00577167	0.00577167	2.429909152	0.12547584
Residual	49	0.116387812	0.002375261		
Total	50	0.122159482			

	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%	Lower 95.0%	Upper 95.0'
Intercept	0.037495933	0.008237998	4.551583041	3.53081E-05	0.020941066	0.0540508	0.020941066	0.054051
ILEC in LD market	0.022926714	0.014707769	1.558816587	0.12547584	-0.006629636	0.052483063	-0.006629636	0.052483

SUMMARY OUTPUT **Percent of CLEC Lines that are Facilities-based**

Regression Statistics	
Multiple R	0.094474025
R Square	0.008925341
Adjusted R Square	-0.011300672
Standard Error	0.331880266
Observations	51

ANOVA

	df	SS	MS	F	Significance F
Regression	1	0.048604603	0.048605	0.441280302	0.509619221
Residual	49	5.397081023	0.110145		
Total	50	5.445685626			

	Coefficients	Standard Error	t Stat	P-value	Lower 95%	Upper 95%	Lower 95.0%	Upper 95.0%
Intercept	0.459637819	0.056098004	8.193479	9.68282E-11	0.346904728	0.57237091	0.346904728	0.57237091
ILEC in LD market	0.066531877	0.10015497	0.664289	0.509619221	-0.134736948	0.267800702	-0.134736948	0.267800702

SUMMARY OUTPUT **CLEC Residential Facilities Based Market Share**

Regression Statistics	
Multiple R	0.143953051
R Square	0.020722481
Adjusted R Square	0.000737225
Standard Error	0.020244091
Observations	51

ANOVA

	df	SS	MS	F	Significance F
Regression	1	0.000425	0.000425	1.036888	0.313548
Residual	49	0.020081	0.00041		
Total	50	0.020506			

	Coefficients	Standard E	t Stat	P-value	Lower 95%	Upper 95%	Lower 95.0	Upper 95.0%
Intercept	0.014048762	0.003422	4.105573	0.000152	0.007172	0.020925	0.007172	0.020925275
ILEC in LD market	0.006220931	0.006109	1.018277	0.313548	-0.006056	0.018498	-0.006056	0.018497962

Attachment 3

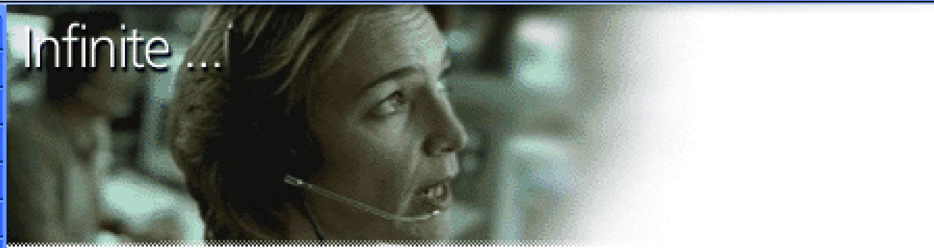
SBC's Website Provides No Information About or Links To its Out-of-Region CLEC Services

Data delayed 20 minutes. Provided by Shareholder.com | Stock Price | 26.10 -0.11

SBC Communications Inc.
Data Capabilities
Public Affairs
Community
Press Room
Careers
Investor Relations
Products/Services
International

SEARCH refine

Contact Us
Site Map
Glossary



In Depth}

- SBC READY TO ASSIST: SBC Communications Inc. is prepared to accommodate new customers looking for dependable, reliable voice and data services during the current uncertainty in the telecommunications industry
- SBC/Yahoo! Dial: SBC and Yahoo! Launch National Co-Branded Dial Service
- SBC/Cingular: Discounted packages featuring SBC services and Cingular wireless
- Broadband Watch: The second annual *Business Broadband Watch* study of SBC's small business customers

Headlines

SBC Communications Reports Second-Quarter Earnings of $0.55 Per Diluted Share; $0.61 Per Diluted Share Before Special Items

SBC Calls Unbundling Rules and UNE-Platform "Devastating"

Sterling Commerce Introduces Electronic Commerce Outsourcing Services

New Sterling Commerce Modular Product Strategy Delivers Advanced Integration Capabilities for Gentran Customers

Products}

SBC sells products and provides services online through its brand Web sites. Visit these sites to learn more about...

- Internet
- Long Distance
- Voice Communications
- e-Business

Our Brand Sites

- SBC Southwestern
- SBC Ameritech
- SBC Pacific
- SBC Nevada
- SBC SNET

Products/Services

Through SBC subsidiaries' trusted brands — SBC Southwestern Bell, SBC Ameritech, SBC Pacific Bell, SBC Nevada Bell, SBC SNET, and Sterling Commerce — and world-class network, SBC companies provide a full range of voice, data, networking and e-business services to address the specific needs of individual businesses and consumers. SBC is America's leading provider of high-speed DSL Internet access service, and one of the nation's leading Internet Service Providers (ISPs).

SBC companies currently have nearly 60 million access lines nationwide. SBC also has a 60 percent equity interest in Cingular Wireless, its joint venture with BellSouth, which serves more than 22 million wireless customers.

SBC services include:

- local and long-distance
- high-speed Internet access and data transport
- network integration
- software and process integration
- Web site and application hosting
- business to business commerce solutions
- messaging
- directory advertising and publishing

To find out more about our products and services, you may either search by geographic location or by brand.

Special Features

Internet Survey: The World Wide Web's Past, Present and Future.

For More Information

To find out more about our products and services, you may either search by:
Geographic Location
Brand

Related Links

SBC Southwestern Bell

SBC Ameritech

SBC Pacific Bell

SBC Nevada Bell

SBC SNET

Sterling Commerce

Cingular Wireless

Prodigy

Products/Services

Brand and Markets

SBC Communications Inc. serves 20 of the largest U.S. markets and has telecommunications investments in 28 countries. Under the SBC Southwestern Bell, SBC Ameritech, SBC Pacific Bell, SBC Nevada Bell, SBC SNET, Sterling Commerce, and Prodigy brands, SBC provides a full range of voice, data, networking and e-business services. SBC also has a 60 percent equity interest in Cingular Wireless, its joint venture with BellSouth, which serves more than 21 million wireless customers.

In the 2001 J.D. Power national customer satisfaction survey of local telephone customers, SBC SNET ranked No. 2 for residential local service in 2001. In addition, SBC Southwestern Bell ranked No. 2 and SBC SNET ranked No. 3 for residential long-distance service.

To find out more about our products and services, search by geographic location or by brand.

Brand	Location
SBC Southwestern Bell	South Central United States
SBC Ameritech	Upper Midwest
SBC PacificBell	California
SBC Nevada Bell	Nevada
SBC SNET	Connecticut
Sterling Commerce	
Cingular	
Prodigy	

SBC Southwestern Bell
In the South Central United States, SBC provides telecommunications services under the SBC Southwestern Bell brand to millions of business and residential customers throughout Texas, Missouri, Oklahoma, Arkansas and Kansas. Products and services provided in our five-state territory include: local and long distance service, data communications and e-business services, DSL Internet and dial-up Internet access, and advertising and directory services.

top

SBC Ameritech
In the Upper Midwest, SBC provides a wide array of communications services to customers in Illinois, Indiana, Michigan, Ohio, and Wisconsin under the SBC Ameritech brand. Products and services include local telephone and data services, directories and DSL and dial-up Internet access.

top

Special Features

Internet Survey: The World Wide Web's Past, Present and Future.

Related Links

SBC Southwestern Bell
SBC Ameritech
SBC Pacific Bell
SBC Nevada Bell
SBC SNET
Sterling Commerce
Cingular Wireless
Prodigy

SBC Pacific Bell
For more than 100 years, SBC Pacific Bell has provided telecommunications services, today totaling more than 17 million access lines. Our product portfolio includes data communications and e-business services, DSL and dial-up Internet access, and directory services.

top

SBC Nevada Bell
Our SBC Nevada Bell brand serves roughly 30 percent of the access lines in the state of Nevada, including the Reno/Sparks metropolitan area and widespread rural territories. With 100 percent digital switching for our more than 350,000 access lines, SBC Nevada Bell provides residential and business customers with one of the nation's most advanced public networks.

top

SBC SNET
SBC SNET is a leading information and communications provider in Connecticut, offering a full range of wireline products including local and long-distance wireline service, data communications and e-business services, dial-up and DSL Internet access and directory services.

top

Sterling Commerce
Sterling Commerce, a wholly owned subsidiary of SBC, is a worldwide leader in business-to-business integration -- providing a wide range of integration software, business enabling and online services. With more than 25 years of experience in a range of industries, Sterling Commerce offers expertise, as well as the breadth of integration software and services required, to facilitate, manage and support the electronic exchange of information within a business, as well as with its diverse community.

top

Cingular
Cingular Wireless is a joint venture between the wireless divisions of SBC and BellSouth. SBC has a 60 percent equity interest in Cingular Wireless, which serves more than 21 million wireless customers.

top

Prodigy
Prodigy Communications, a subsidiary of SBC Communications, offers a reliable, high-quality dial-up network that covers more than 850 locations in all 50 states with local call access from 90 percent of the country.

top

Products/Services

Voice Communications

SBC offers Voice Communications in the states listed below. Select residential or business, and your state, to view the phone service features available in your area:

Residential - select your state

- Arkansas
- California
- Connecticut
- Illinois
- Indiana
- Kansas
- Michigan
- Missouri
- Nevada
- Ohio
- Oklahoma
- Texas
- Wisconsin

Business - select your state

- Arkansas
- California
- Connecticut
- Illinois
- Indiana
- Kansas
- Michigan
- Missouri
- Nevada
- Ohio
- Oklahoma
- Texas
- Wisconsin

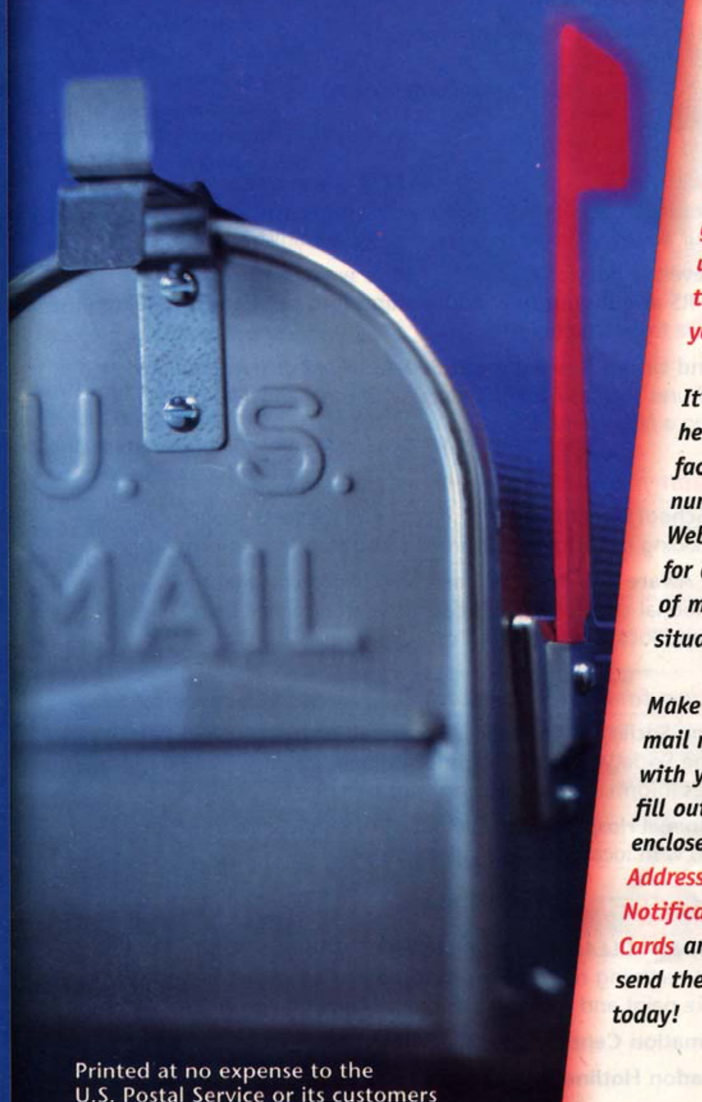
Attachment 4

United States Postal Service
"Mover's Guide"
Identifying only BOCs as
Local Telephone Service Providers

May–August 2001
Pub. 75 Vol. 22

UNITED STATES POSTAL SERVICE®

Mover's Guide



Keep this guide and use it throughout your move!

It's full of helpful tips, facts, phone numbers and Web sites for all types of moving situations.

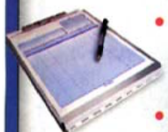
Make sure your mail moves with you—fill out the enclosed Address Notification Cards and send them today!

Printed at no expense to the U.S. Postal Service or its customers

Helpful Tips for an Easier Move

Valuable strategies for moving your stuff, your kids, your pets and yourself to your new home

Do your homework Before you hire a moving company, the United States Department of Transportation recommends the following:



- Get written estimates from at least three companies. Ask about the conditions of each estimate (for example, whether the final cost is guaranteed not to exceed the estimate by a certain amount).
- Ask for each company's motor carrier number and call USDOT at 202-358-7000 to verify that they are properly registered and insured.
- Ask your moving company for a copy of *Your Mover's Rights and Responsibilities*.
- Visit the USDOT Web site: *www.fmcsa.dot.gov/factsfigs/moving.htm*
  United States Department of Transportation

On moving day

- Accompany the driver as he or she inspects your items and fills out your inventory. Make sure everything is on the truck before signing any releases.
- At your new home, compare the condition of your goods against the inventory and check for any missing items.

Involve your kids

- Have your children pack and label a few boxes of their own, so they know their favorite stuff won't be left behind.
- Help your children learn about their new town. Visit your local library or bookstore to find books about the area you're moving to.

How can you make moving fun for kids? Go to *www.usps.com/moversnet* for ideas.

Take care of your pet

- Pack a "pet moving kit" with food, medications, medical records and your vet's phone number.
- Be sure your cat or dog is wearing an ID tag, in case he or she gets loose.
- If you're traveling a long distance, check ahead to see that your flights, accommodations and so on are pet friendly.

Get tips on moving dogs, fish, even snakes at *www.usps.com/moversnet*

How to stay connected when you move If possible, call your new local phone company a month before you move and ask for your new number. Here are some local phone service options:*

- For moves to AL, FL, GA, KY, LA, MS, NC, SC and TN: Call BellSouth at 1-877-340-7576.
- For moves to AZ, CO, IA, ID, MN, MT, ND, NE, NM, OR, SD, UT, WA and WY: Call directory assistance for the Qwest office in your new area.
- For moves to DC, DE, MA, MD, ME, NH, NJ, NY, PA, RI, VA, VT and WV: Call directory assistance for the Verizon office in your new area.
- For moves to other states, call directory assistance for the phone numbers of local phone companies in your new area. Remember to check on local cellular companies, too.

* *Service providers may be different in some areas.*

How to stay connected with long distance when you move

- Once you know your new phone number, the next step is choosing a long distance carrier. Your local phone company will not transfer your present long distance savings plan and other services (like calling cards) automatically.
- You'll need to call the different carriers yourself to ensure the best rates, calling and savings plans, and uninterrupted service. This is a good opportunity to find out which carriers offer the best rates for your new location and long-distance needs.
- If you switch long-distance carriers, you may be charged a small, one-time fee—so be sure to ask your new carrier if they'll reimburse you or credit your new account.

Attachment 5

SBC Rejects Long Distance Service Orders Placed by Consumers who are not also SBC Local Service Customers

Data delayed 20 minutes. Provided by Shareholder.com | Stock Price 31.82 1.32

SBC Communications Inc.
Data Capabilities
Public Affairs
Community
Press Room
Careers
Investor Relations
Products/Services
International

SEARCH refine

Contact Us
Site Map
Glossary

In Depth}

- Networld + Interop: SBC announces new class of managed IP VPN and enhanced Web hosting services through its extended national data network
- Broadband Watch: The second annual *Business Broadband Watch* study of SBC's small business customers
- SBC Excelerator: A $25 million initiative to create digital connections with America's underserved
- SBC/EchoStar: Alliance to offer bundled DSL Internet, Digital Satellite Television

Headlines

SBC Offers New Class of Managed IP Virtual Private Network Services

SBC E-services Delivers Enhanced Managed Hosting Services Portfolio

SBC Receives Presidential Award for Corporate Leadership

SBC Calls New Senate Broadband Bill a Positive Step

Products}

SBC sells products and provides services online through its brand Web sites. Visit these sites to learn more about...

- Internet
- Long Distance
- Voice Communications
- e-Business

Our Brand Sites

- SBC Southwestern
- SBC Ameritech
- SBC Pacific
- SBC Nevada
- SBC SNET

- SBC Communications Inc.
- Data Capabilities
- Public Affairs
- Community
- Press Room
- Careers
- Investor Relations
- Products/Services
- Brands and Markets
- International

SEARCH refine

- Contact Us
- Site Map
- Glossary

Products/Services

Long Distance

SBC offers long distance service in the states listed below. Select residential or business, and your state, to view the long distance features available in your area:

Residential - select your state

- Arkansas
- Kansas
- Missouri
- Oklahoma
- Texas

Business - select your state

- Arkansas
- Kansas
- Missouri
- Oklahoma
- Texas

Texas

Long Distance Calling Plans

Long Distance Domestic Calling Plans - compare these plans

SBC Domestic Saver sm	ORDER NOW
SBC Domestic Saver Gold sm	ORDER NOW
SBC Long Distance	ORDER NOW
SBC Block of Time: 300 minutes	ORDER NOW
SBC Block of Time: 500 minutes	ORDER NOW
SBC 500 Block of Time Gold	ORDER NOW

Long Distance International Calling Plans - compare these plans

International Saver sm	ORDER NOW
International SuperSaver sm	ORDER NOW
SuperMexico 60 sm	CALL TO ORDER
SuperMexico 180 sm	CALL TO ORDER

Home
My Account
Online Account Manager
Residential Products and Services
Business Products and Services
Repair
Billing and Account
Employment
About Southwestern Bell

Site Search

SEARCH

SMARTpages™
White and Yellow Pages
Site Map
FAQs
Contact Us

Enter Sweepstakes
Also, sign up for news, tips and promotions.
Enter Email Address

GO

Residential Products and Services

Español

Texas

All Products and Services | Money Savers | Long Distance | Phone Service Enhancements | Improving Internet Access | Phone Equipment | Lines, Wiring and Jacks

Long Distance Calling Plans: SBC Block of Time: 300 minutes

CONTINUE SHOPPING

GET RECOMMENDATIONS

SBC Block of Time: 300 minutes

ORDER NOW

Order SBC Block of Time: 300 minutes from SBC Long Distance and receive a coupon redeemable for a $18.00 check. Offer available to *new SBC Southwestern Bell Long Distance customers May 6, 2002 through August 4, 2002.

Call from home to anyone, anytime, anywhere. 300 minutes of domestic, direct dialed calls for one low monthly rate.

Features
Pricing
International Calling Plans
Service and Support
FAQs

Features

- Get up to 300 domestic minutes of direct dialed calls from home to anywhere in-state and/or out-of-state, anytime.
- Fixed charge each month makes it easy to budget.
- You'll have just one bill to pay each month for your local and long distance service.
- Please view our Long Distance International Dialing Guide.

You will need Adobe Acrobat Reader to view the Long Distance International Dialing Guide.

Pricing

- $18.00 per month.
- Excess minutes at a low flat rate of 6 cents each minute.

- Other charges apply when using a pay phone or operator assistance.
- Calling card calls are not included in 300 minute block of time.
- Other charges apply when using a payphone or operator assistance.
- Please view our complete summary of long distance calling card per call charges.
- Please view our complete summary of alternate billed services call charges.

International Calling Plans
If you make International Calls, look here for information regarding our great International Calling Plans.

Service and Support

Call 1-800-227-5574 Monday through Thursday 8 am to 8 pm, Friday and Saturday 8 am to 6 pm.

*New SBC Long Distance subscribers will receive a coupon redeemable for a $18 check. By placing an order for this promotion, customer verifies they are a new SBC Southwestern Bell Long Distance customer. Instructions on coupon completion and submission will be provided with the coupon. The coupon must be filled out and submitted to SBC Long Distance in order to receive the check. The $18 check will be mailed out within 2 – 3 weeks following receipt of the coupon.

Note: SBC Long Distance provides long distance where arrangements exist with local providers in the SBC Southwestern Bell Telephone Company service area. Availability, rates and conditions subject to change. SBC and Southwestern Bell are registered trademarks of SBC Communications Inc.

CONTINUE SHOPPING ORDER NOW

Authentication

Enter either your User ID and password OR enter your main telephone number.

User ID:

Password:

[Forgot your User ID and/or Password?]

-- Or --

Your main telephone number: 972 - 252 - 9970

CONTINUE CANCEL I AM NOT A SOUTHWESTERN BELL CUSTOMER

SBC Southwestern Bell

Call To Order

Thank you for visiting our web site, however we are unable to process your order to purchase Southwestern Bell services or telephone equipment online. Your shopping cart will be emptied. Please contact us at 1-800-310-BELL (2355).

CONTINUE